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REPORT OF THE BOARD

January, 1985

In the matter of
applications under the
Ontario Energy Board Act
by
Inter-City Gas Corporation,
ICG Resources Ltd. and
Vigas Propane Ltd.
and
Norcen Energy Resources
Limited

E.B.O. 119
E.B.O. 118



Ontario
Energy
Board

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REPORT OF THE BOARD

January, 1985

E.B.O. 118/119

IN THE MATTER OF the Ontario Energy Board Act, R.S.O., 1980, Chapter 332, as amended;

AND IN THE MATTER OF an application by Inter-City Gas Corporation, ICG Resources Ltd. and Vigas Propane Ltd. for leave of the Lieutenant Governor in Council of the Province of Ontario to acquire in excess of 20 percent of the issued and outstanding common shares of Northern and Central Gas Corporation Limited;

AND IN THE MATTER OF an application by Norcen Energy Resources Limited for leave of the Lieutenant Governor in Council of the Province of Ontario to acquire in excess of 20 percent of the issued and outstanding First Preference Shares of Inter-City Gas Corporation.



BEFORE: Richard R. Perdue, Q.C.
Presiding Member

Robert W. Macaulay, Q.C.
Chairman

Donald H. Thornton, Q.C.
Member

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APPEARANCES

Parties to the Hearing: **Represented By:**

1. The Applicants -

a) Inter-City Gas Corporation	J.D. Brett
b) ICG Resources Ltd.	A. Sweatman, Q.C.
c) Vigas Propane Ltd.	
d) Norcen Energy Resources Limited	F.A.M. Huycke, Q.C.

2. Special Counsel **J.A. Campion**

3. Intervenors -

a) Federation of Northern Ontario Municipalities	J.E. Johnson
b) The Consumers' Gas Company Ltd.	R.S. Paddon, Q.C.
c) Union Gas Limited	J.B. Jolley, Q.C.
d) TransCanada PipeLines Limited	C. Black B. Hulse

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LIST OF WITNESSES

The following witnesses gave testimony at the hearing and appeared in the order listed:

Witnesses:

R.G. Graham

Position Held:

President and Chief Executive Officer, Inter-City Gas Corporation

P. Marriott

Senior Vice President and Chief Financial Officer, Inter-City Gas Corporation

G.S. Lackenbauer

Senior Vice President and Director, Nesbitt Thomson Bongard Inc., appearing for Inter-City Gas Corporation

T.G. Sheeres

Vice President of Finance, Norcen Energy Resources Limited

R.E. Venn

Vice President and Director, Wood Gundy Inc., appearing for Norcen Energy Resources Limited

D.N. Fraser

Senior Vice President, Richardson Greenshields of Canada Limited, appearing for Inter-City Gas Corporation

Dr. W.T. Cannon

Associate Professor of Finance, School of Business, Queen's University, appearing for Special Counsel

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SHORT FORMS

Act	- Ontario Energy Board Act
Board	- Ontario Energy Board
CBRS	- Canadian Bond Rating Service
CIBC	- Canadian Imperial Bank of Commerce
DBRS	- Dominion Bond Rating Service
EBIT	- Earnings before interest and taxes
FONOM	- Federation of Northern Ontario Municipalities
GMi	- Gaz Metropolitain, inc.
Greater Winnipeg	- Greater Winnipeg Gas Company
Inter-City	- Inter-City Gas Corporation
Le Gaz	- Le Gaz Provincial du Nord de Quebec
MICC	- Mortgage Insurance Company of Canada
Norcen	- Norcen Energy Resources Limited
Northern	- Northern and Central Gas Corporation Limited
Preference Shares	- Series A First Preference Share of Inter-City
Resources	- ICG Resources Ltd.
Richardson Greenshields	- Richardson Greenshields of Canada Limited
Vigas	- Vigas Propane Ltd.

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CHAPTER 1: INTRODUCTION TO THE APPLICATIONS

**THE NATURE
OF THE
APPLICATIONS**

The subject matter of this report is an Agreement dated October 30, 1984 (the "Agreement") whereby Inter-City Gas Corporation ("Inter-City"), ICG Resources Ltd. ("Resources"), and Vigas Propane Ltd. ("Vigas") propose to acquire 100 percent of the common shares of Northern and Central Gas Corporation Limited ("Northern"), which are currently owned by Norcen Energy Resources Limited ("Norcen"). The Agreement also proposes a concurrent acquisition by Norcen resulting in Norcen owning 34.7 percent of the voting First Preference Shares of Inter-City.

The Ontario Energy Board (the "Board") is empowered to review this transaction under Section 26 of the Ontario Energy Board Act (the "Act").

The relevant subsections of Section 26 of the Act state:

(2) No person, without first obtaining the leave of the Lieutenant Governor in Council, shall acquire such number of any class of shares of a gas transmitter, gas distributor or storage company that together with shares already held by such person or by such person and an associate or associates of such person will in the aggregate exceed 20 per cent of the shares outstanding of

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that class of the gas transmitter, gas distributor or storage company.

(4) An application for leave under this section shall be made to the Board, which shall hold a public hearing and submit its report and opinion to the Lieutenant Governor in Council.

As both of the proposed acquisitions amount to a transfer of more than 20 percent of the shares outstanding in a class of shares of the respective companies, Section 26 requires that the two companies make separate Applications (the "Applications") for leave of the Lieutenant Governor in Council.

Section 26 of the Act is applicable when the company in question is one which is subject to the jurisdiction of, and regulation by, the Board. Northern is the third largest gas utility in Ontario and Inter-City has a natural gas distribution system in northwestern Ontario. Therefore, both Northern and Inter-City are "distributors" in Ontario, within the meaning of the Act, and are subject to regulation by the Board.

Due to the interlocking interests of the Applicants, the Board decided to hear the Applications concurrently.

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Although Section 26 does not specifically mention the public interest, the Applicants were asked in the Board's Procedural Order to address their evidence to show how the proposed transactions would affect the public interest defined to include:

1. the present and potential shareholders and customers of Northern;
2. the shareholders and Ontario customers of Inter-City;
3. the Ontario communities served by Northern and by Inter-City;
4. the investors in Northern other than the shareholders;
5. the consumers in the Province of Ontario who would benefit from securing natural gas transmission, storage and distribution at a reasonable cost; and
6. the public interest generally.

In this report, the Board has attempted to recount to His Honour the Lieutenant Governor the thrust of the more significant evidence which came

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before the Board, as well as the resulting recommendations of the Board.

BACKGROUND

The following is a chronology of the relevant dates touching upon the two Applications and the hearing:

Spring 1984 - First discussions concerning the proposed purchase by Inter-City of the shares of Northern from Norcen.

Sept. 7, 1984 - Letter of Intent executed by Inter-City and Norcen.

Oct. 30, 1984 - Agreement between Inter-City, Resources and Vigas (as Purchasers) and Norcen (as Vendor) executed.

Oct. 31, 1984 - Application of Inter-City, Resources and Vigas.

Nov. 1, 1984 - Application of Norcen. Both Applications hand delivered to the Board.

Nov. 5, 1984 - Procedural Order of the Board.

Nov. 13, 1984 - Filing of pre-filed evidence of the Applicants.

Nov. 20, 1984 - Final date for interventions.

Nov. 21, 1984 - Final date for presenting interrogatories to the Applicants.

Nov. 26, 1984 - Final date for answers to interrogatories.

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Nov. 30, 1984 - Original closing date fixed by Inter-City, Resources, Vigas and Norcen in the Agreement.

Dec. 3, 1984 - Commencement of the hearing.

Dec. 6, 1984 - Last day of the hearing.

Dec. 10, 1984 - Oral Argument.

Dec. 31, 1984 - Revised closing date verbally agreed to by Inter-City, Vigas, Resources and Norcen.

Jan. 31, 1985 - Further revised closing date agreed upon between the parties.

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**CHAPTER 2: BACKGROUND INFORMATION ON
THE PARTIES TO THE AGREEMENT**

NORTHERN

Northern is presently a wholly-owned subsidiary of Norcen. It was incorporated by Letters Patent in the Province of Ontario on January 1, 1968, and arose out of an amalgamation of three inter-related Ontario gas distributors, namely:

- i) Northern and Central Gas Company Limited (formerly Northern Ontario Natural Gas Company);
- ii) Twin City Gas Company Limited; and
- iii) Lakeland Natural Gas Limited.

Northern presently owns and operates, either directly or through subsidiaries, natural gas distribution facilities in three operating areas: Ontario, Quebec and Manitoba. At December 31, 1983, Northern's total assets amounted to \$711,956,000.

Northern's Ontario operations serve approximately 140,000 customers, in approximately 114 communities in northwestern, northern and eastern Ontario.

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Northern's operations in Ontario consist principally of gas distribution. Beyond this, Northern owns and operates a gas liquefaction and storage plant located near Sudbury which provides additional gas on days of peak demand during the winter months. The collective operations of Northern, Northern Ontario Acceptance Company Limited ("Northern Acceptance"), Northern and Central Realty Limited ("Northern Realty"), and Nortwin Development Company Limited ("Nortwin") are generally referred to as the Ontario operations.

Northern distributes natural gas in Manitoba through its 99.9 percent owned subsidiary Greater Winnipeg Gas Company ("Greater Winnipeg"). Greater Winnipeg serves approximately 160,000 customers in and around the Winnipeg area. In 1983 the contribution made by Greater Winnipeg to Northern's income amounted to \$6,300,000.

Greater Winnipeg, in turn, owns 100 percent of Winnex Ltd. ("Winnex"), a Canadian corporation, whose principal assets are oil and gas producing properties and exploration properties in Alberta.

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The Winnex shares represent approximately 1.06 percent of the total adjusted cost base to Norcen of the Northern shares. The parties to the Agreement have excluded them from the sale of Northern and the details of this part of the transaction are discussed in Chapter 4 of this report.

Northern's natural gas distribution facilities in Quebec are operated through its 100 percent owned subsidiary Le Gaz Provincial du Nord de Quebec ("Le Gaz"). Le Gaz distributes natural gas in the areas of Noranda, Rouyn and Temiskaming.

Between 1967 and 1980 Northern was also involved in the distribution of natural gas in Montreal through its then subsidiary Gaz Metropolitain, inc. ("GMI"). In 1980 and 1981, with the consent of the holders of its first mortgage bonds, Northern issued two series of debentures which are exchangeable into Northern's entire common shareholdings of GMI. The holders of these debentures in the meantime possess the right to vote the GMI common shares held by

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Northern. In addition, Northern owns certain preference shares and debt securities of GMi.

Northern's distribution system can be seen more clearly by referring to the map included in Appendix A.

NORCEN

Norcen is engaged in the exploration and production of oil and natural gas in Alberta, British Columbia, Saskatchewan, the Beaufort Sea and offshore east coast, as well as in the United States and Australia. Through its subsidiaries and affiliates, Norcen participates in significant iron ore operations in Newfoundland. At December 31, 1983, Norcen's total assets amounted to \$2,129,223,000.

While Norcen's principal business is the exploration for and the development and production of oil and natural gas, Norcen also has significant utility interests (i.e. Northern and its subsidiaries). Norcen presently owns all of the issued and outstanding common shares of Northern, as well as all of Northern's third preference

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shares which are the only other existing voting shares.

It is Norcen's position that since 1975 it has been evolving from primarily a gas utility with resource interests into a major North American resource company. The sale of Northern, Norcen's utility division, is seen by Norcen to be a further step in this evolution.

INTER-CITY

Inter-City is a Manitoba corporation that has been involved directly, and indirectly through its subsidiaries, in various aspects of the energy industry throughout Canada since 1954. The consolidated assets of Inter-City, according to its financial statements as at December 31, 1983, are \$814,491,000. Its operations are divided into four divisions which are described below.

Inter-City's liquid gas division is Canada's leading distributor of propane and industrial gases as well as related home and recreational appliances and commercial and industrial equipment.

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Inter-City's utility division comprises 30 percent of its business. These operations include gas distribution systems in British Columbia, Alberta, Manitoba, Ontario, and the state of Minnesota. Within northwestern Ontario the system services the communities of Fort Francis, Rainy River, Chapple and Emo. In addition, Inter-City holds the franchise rights for the province of New Brunswick and is a 49 percent partner in Gaz Inter-Cite Quebec, the natural gas distributor now extending service to most of Quebec east of Montreal. If this proposed transaction is approved, Inter-City's utility operations will increase to a level where they will account for 67 percent of its business.

The manufactured products division of Inter-City is comprised of two of Inter-City's subsidiary companies: KeepRite Inc. of Brantford, Ontario, and Thompson Pipe and Steel Company of Denver, Colorado. This division manufactures a variety of heating products and pipe.

Inter-City's resources division explores for and develops oil and natural gas properties and

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operates natural gas processing plants. This division is active in both Canada and the United States.

RESOURCES

Resources, a Canadian corporation, is a wholly-owned subsidiary of Inter-City. Resources is engaged in the exploration, development, and production of petroleum and natural gas in Canada.

VIGAS

Vigas is a British Columbia corporation engaged in the merchandising of propane in British Columbia. Vigas is indirectly a wholly-owned subsidiary of Inter-City.

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CHAPTER 3: THE TRANSACTION

INTRODUCTION

The Agreement calls for Inter-City to purchase 48 percent of Northern's common shares, for Resources to purchase a further 48 percent, and for Vigas to purchase the remaining 4 percent. The salient features of the proposed transaction that affect or might affect the public interest are outlined below.

PURCHASE

PRICE The agreed purchase price for the Northern common shares is \$240,000,000. The three proposed purchasers are to pay \$163,000,000 in cash on closing. The remainder of the purchase price is to be paid by the issuance of 110,000 8 percent Series A First Preference Shares of Inter-City which have a redemption value of \$77,000,000. There is an intermediate stage in which Resources and Vigas will actually issue preference shares to Norcen as part of the purchase price. Thereafter Inter-City will exchange its Preference Shares for the preference shares of Resources and Vigas held by Norcen. The end result is that Norcen will

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ultimately hold only Inter-City Preference Shares to complete the purchase price.

**ADJUSTMENTS
TO PURCHASE
PRICE**

The Agreement provides that the purchase price of \$240,000,000 has been established on the basis that consolidated retained earnings of Northern, as defined in the Agreement, will be \$88,142,000 at December 31, 1984. If they are less, Norcen shall, on March 1, 1985, pay the difference to the purchasers. If consolidated retained earnings exceed \$88,142,000, then the purchasers shall, on March 1, 1985, pay to Norcen the amount of such excess.

**INTER-CITY
PREFERENCE
SHARES**

The \$77,000,000 of Series A First Preference Shares to be held by Norcen are entitled to be voted as a separate class. They must be totally redeemed by Inter-City according to a schedule that commences on January 1, 1988 when Inter-City must redeem \$8,000,000 worth of the Preference Shares annually to 1990. A further \$10,000,000 must be redeemed in each year from 1991 to 1993, \$12,000,000 in 1984 and \$11,000,000 in 1995. The

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provisions attached to the shares provide that, if Inter-City fails to pay the dividend in any given year, or fails to redeem in accordance with the redemption schedule set out above, Norcen can elect to require immediate redemption of any such shares then outstanding.

**THE NORCEN/
INTER-CITY
NOTE**

As part of the overall transaction it is proposed that an outstanding promissory note held by Northern as an obligation of Norcen (the "Norcen Note") be assigned to Inter-City and that Inter-City issue an identical note to Northern (the "Inter-City Note"). Thus, the Norcen Note would no longer be a debt obligation from Norcen to Northern but would be a debt obligation between Norcen and Inter-City. A further debt obligation from Inter-City to Northern would be created by the second note, the Inter-City Note. The Norcen/Inter-City Notes are each 7.6 percent promissory notes for \$47,300,000.

As between Norcen and Inter-City, the Agreement provides that, should Inter-City default on any of its dividend or redemption payments

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associated with the Inter-City Preference Shares, Norcen would have a right to set off the default against its obligations on the Norcen Note. As well, Inter-City would have the right to set off against the payments due under its Preferred Shares held by Norcen the amount of any default by Norcen under the Norcen Note.

WINNEX SHARES

The Winnex shares, which are currently owned by Greater Winnipeg, are to be transferred to Norcen before the closing of the Agreement. The fair market value of the shares is \$19,000,000. Norcen, however, will initially pay Greater Winnipeg the book value of these shares (approximately \$10,000,000). Eventually Greater Winnipeg will dividend this amount back to Norcen through Northern.

**THE
RESULTING
CORPORATE
STRUCTURE**

After the transaction is completed, Norcen will still retain the third preference shares of Northern it presently holds but the common shares of Northern held by Norcen will be entirely owned by Inter-City and its subsidiaries. The public

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will retain, as before, all of the first preference and second preference shares of Northern.

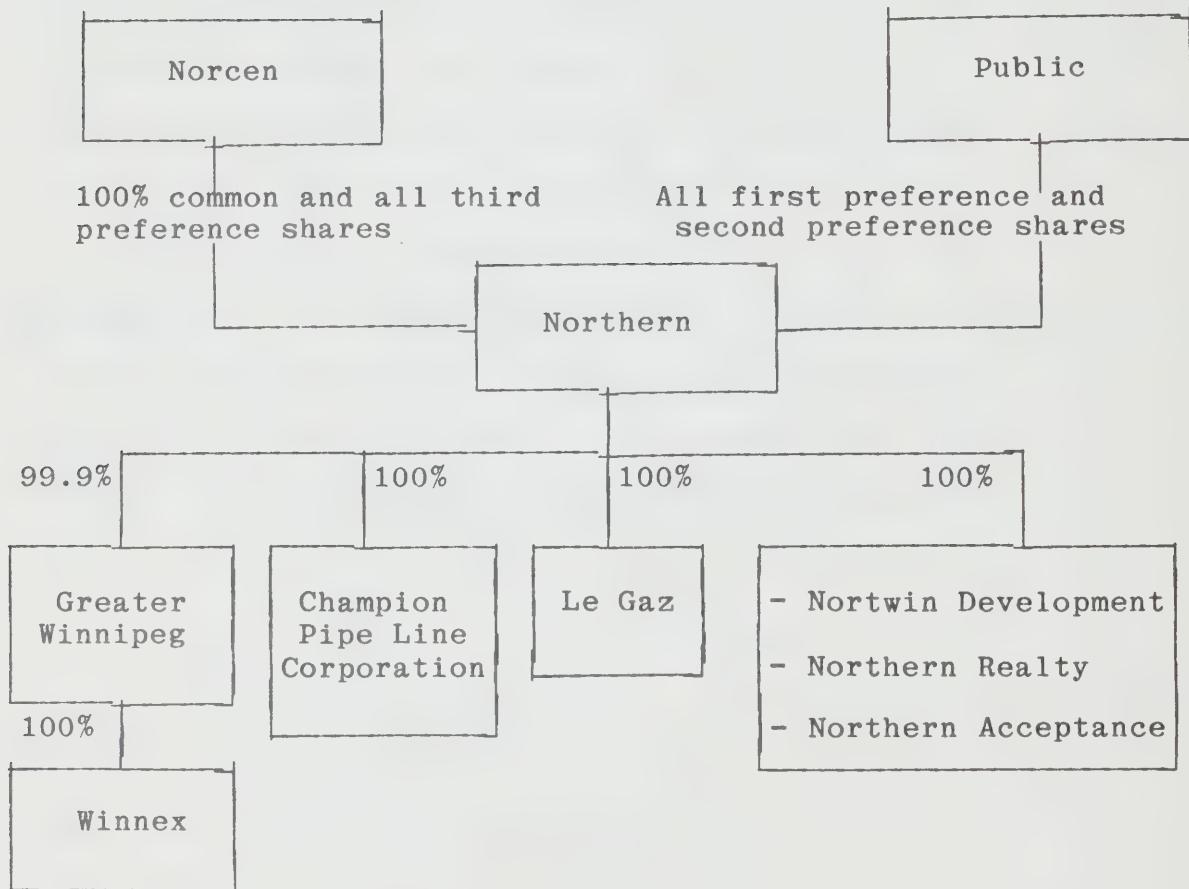
With the exception of the Winnex shares (which will no longer be owned by Greater Winnipeg), the evidence showed that the corporate organizational structure of Northern will remain unchanged should the applications be approved.

Pictorial representations of Northern's corporate structure as it currently exists (Figure 1), and as it will exist should the proposed transaction be approved (Figure 2) can be seen as follows:

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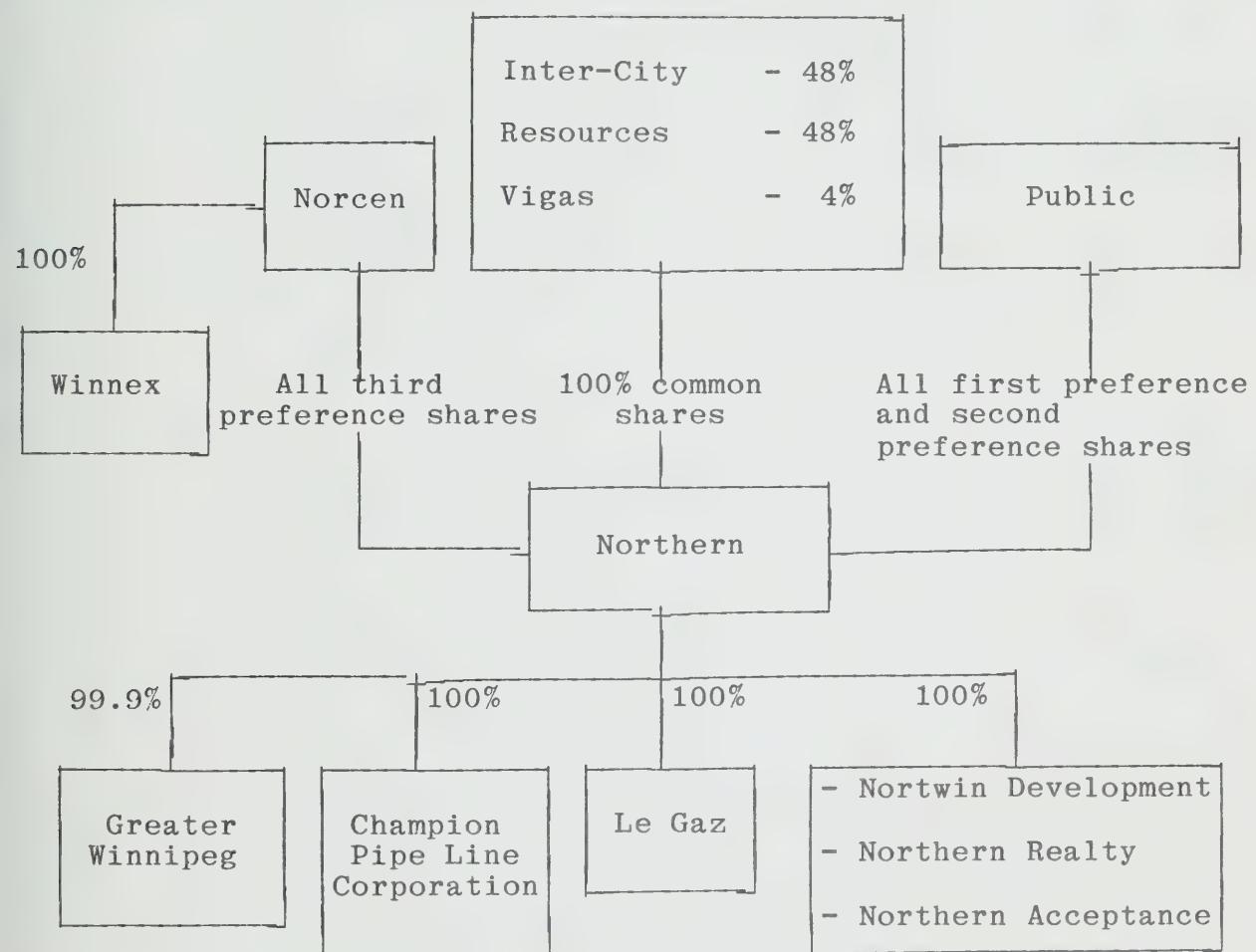
Figure 1
Corporate Structure of Northern
Prior to Agreement



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Figure 2
Corporate Structure of Northern
After the Closing of the Agreement



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CHAPTER 4: THE EVIDENCE

THE AGREEMENT **Amendments**

The Agreement, as summarized in Chapter 3, comprises the whole of the contract existing between the parties with a few minor technical amendments for tax purposes.

Approvals

Mr. Sheeres testified that all the necessary tax rulings pertaining to the Agreement had been obtained as well as the required consent of every bank, trustee and security holder.

Mr. Marriott explained that of Inter-City's preferred shareholders only the holders of series B and C first preference shares have the right to approve or disapprove the proposed issuance of the Series A First Preference Shares. Mr. Marriott assured the Board that the transaction had been put to holders of these shares and that sufficient approvals had been received. He stated that the approvals of series A and B second preference

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shares, and that of the common shareholders, are not required and thus had not been obtained.

Trust indentures attached to some of Northern's first mortgage bonds specify that Northern must obtain the approval of the holders of these bonds for a change in control. These bondholders refused to approve the proposed change until Norcen agreed to purchase the Northern bonds and replace them with Norcen bonds.

Closing Date

The Applicants filed their Applications with the Board November 1, four weeks prior to the proposed date of closing. In doing so, they stated that they were aware that approval would be required from the Lieutenant Governor, and that this approval would require a hearing before this Board. The Board was told that a second closing date of December 31 was acceptable if the transaction could not be approved by November 30. Nevertheless, both parties indicated a common desire to close after December 31 should this further postponement be required. It should be

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noted that the closing date was further extended in Argument to January 31, 1985.

**FINANCING
OF THE
PROPOSED
TRANSACTION**

Mr. Marriott testified that Inter-City intends to finance the \$163,000,000 cash portion of the purchase price by a loan from the Canadian Imperial Bank of Commerce ("CIBC"). Insofar as the funds that are due from Resources and Vigas are concerned, Mr. Marriott testified that Inter-City would borrow the full amount, entirely and solely in its own name, and advance the necessary funds to Resources and Vigas for their portions of the purchase price on the same terms and conditions as the CIBC loan to Inter-City.

The pertinent features of the loan are as follows:

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<u>Tranche</u>	<u>Type of Loan</u>	<u>Maximum (millions)</u>	<u>Maturity</u>	<u>Repayment Terms</u>
A	Bridging Loan	\$65.3	March 31/86 ¹	In full at maturity ¹
B	Term Loan	\$32.5	Note 2	Note 2
C	Term Loan	\$65.2	Dec. 31/89	In full at maturity

Notes:

1. Maturity date is the earlier of March 31, 1986 or the completion of a convertible preferred share issue by Inter-City, the proceeds of which will be utilized to repay this portion of the bank financing.
2. Principal payments in the amount of \$1,670,000 on December 31, 1988, and \$4,150,000 on December 31 each year thereafter until paid in full.

The common shares of Northern will be pledged by Inter-City as security for the loan. With respect to that asset, CIBC will rank ahead of Inter-City's other creditors.

Tranche A of the loan is to be repaid out of the proceeds of a convertible preferred share issue which Inter-City will issue as soon as practicable, following completion of its acquisition of Northern, provided that market conditions do not substantially change in the interim.

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Mr. Marriott referred to a study conducted by Inter-City's underwriter Richardson Greenshields of Canada Limited ("Richardson Greenshields") as proof of the feasibility of the financing plan. In that study the underwriter stated it would be prepared to underwrite and distribute the above mentioned convertible preferred securities. In addition, Mr. Marriott related that all three of Inter-City's bankers who had been approached to provide financing for the cash portion of the consideration (\$163,000,000) had been willing to do so on certain conditions.

FINANCIAL

Introduction

IMPLICATIONS

This section outlines the financial implications of the proposed transaction, and more specifically, the impact on Northern of the proposed change in parent.

Importance of the Parent Company

Witnesses did not agree on the effect that Inter-City's financial strength would have on Northern's ability to attract capital.

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Dr. Cannon stated that in a situation such as this one, the financial strength of the parent organization does matter. He testified that the sponsorship of a strong parent organization would serve to reduce the market's perception of the riskiness of its subsidiaries, and, hence, reduce the cost of capital to these subsidiaries.

He explained that a strong parent organization has the financial resources and market clout to protect its subsidiary should that subsidiary experience financial difficulties, reduced access to external funding, or a need for further equity funding. He suggested that the weak parent corporation may find itself in the embarrassing position of being requested to subscribe to a new equity issue (to help ensure the stability and long-run health of its subsidiary) when to provide such funds would not be convenient or in its best interests.

Mr. Lackenbauer did not deny the relevance of ownership to a utility company's ability to raise capital, or on the resulting cost of capital. He stressed, however, that investors and analysts

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consider the new owner's track record, credibility, stated policies, and undertakings with regard to the utility company, as well as any potential benefits that such an owner may bring to the situation.

He gave examples of the impact, or lack of impact, on the cost of capital and capital attraction felt by other utilities in Canada. He cited the experience of Canadian Utilities Limited ("CUL") which was acquired by a weak parent. The acquisition was said to have had no impact whatsoever on CUL's cost of capital or its ability to attract capital. Mr. Lackenbauer also described the acquisition by Bell Canada Enterprises of approximately 43 percent of TransCanada PipeLines Limited from Dome Petroleum as having had a similar lack of effect on the market's perception of the subsidiary's financial strength. He concluded that a change in parent does not affect market perception.

It was Mr. Lackenbauer's opinion that "the bond rating agencies in Canada will view the change of ownership as a neutral matter". He

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continually emphasized that Northern is viewed in the marketplace on a stand alone basis.

Mr. Sheeres stated that the current bond ratings of Northern will be maintained by both agencies should the proposed transaction be approved.

Mr. Venn testified that the proposed transaction would probably result in both CBRS and DBRS reviewing their ratings of Northern's securities but due to the fact that Northern has always been operated and financed as an independent entity, it was doubtful that the sale would itself result in any change in the ratings.

Mr. Marriott agreed with the other Inter-City witnesses that the identity of a parent is not a factor directly involved in the ratings of a subsidiary. He stated that a great deal depends upon the particular needs of a subsidiary, and the particular parental relationship that exists. The linkage between parental identity and ratings is a matter of degree. He agreed, however, that rating agencies do, in fact, look at a change in parents when embarking upon a rating.

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While Mr. Marriott agreed in principle that a strong parent could be the source of a short term loan for its subsidiary, he did not feel that this factor would affect Northern's ratings. He stated that it was Inter-City's intention to continue the existing policy of allowing Northern to raise its own debt financing, making the identity of the parent company irrelevant.

As outlined earlier, Northern was unable to obtain approval from the holders of Northern's first mortgage bonds for the proposed change in parent. Norcen had been forced to acquire the Northern bonds from these holders and replace them with Norcen bonds. The new Norcen bonds are in the same principal amount but bear a higher interest rate but Northern will not bear any of these extra costs. Witnesses were unable to agree whether this was a negative market reaction to the proposed change in parent, or whether it was simply an opportunistic move by the first mortgage bondholders to obtain a higher interest rate.

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Northern's Need for Equity Capital

The financial implications of the transaction included evidence on Northern's need for equity capital in the future and, in turn, Inter-City's willingness to provide this equity.

It was Mr. Lackenbauer's opinion that, in light of the modest proposed capital expenditure program for Northern over the next five years (approximately \$117,000,000), the reinvestment of Northern's retained earnings alone would be sufficient to allow it to finance its equity requirements internally. He based this opinion on an anticipated 65 percent dividend payout ratio. He said a more modest dividend payout ratio would result in Northern having an unduly thickened equity layer, he said.

Mr. Lackenbauer stated that the only factors which could adversely affect Northern's equity ratio, apart from inadequate rates of return, are rapid growth in the utility operation, and/or a significant diversification program neither of which are anticipated. He stated that the relative financial strength of Inter-City as the

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parent organization is not relevant to Northern's cost of equity.

If for some reason Inter-City proved unable to provide Northern with equity capital as required, Mr. Marriott testified that Northern would be expected to act in its own best interests, and, if necessary, raise equity capital through a public offering. However, it was Mr. Marriott's belief that Northern would not have to go to the market for any of its capital requirements in the near future.

Financial Strength of Inter-City vs. Norcen

As well as the two previous issues, consideration of the financial implication of the transaction included evidence on the relative financial strength of Inter-City and Norcen.

Dr. Cannon stated that, in terms of its financial health, Inter-City is currently in a much weaker position than Norcen. He pointed out that Inter-City is approximately half the size of Norcen in terms of total assets, and in terms of sales revenues.

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Dr. Cannon stated that Norcen's bond ratings are uniformly superior to Inter-City's. He explained that Norcen's secured and unsecured debentures are rated A(low) by DBRS, a full two rating categories above the B+(low) rating that CBRS has assigned to Inter-City's first mortgage bonds, and three rating categories above the B(low) rating that CBRS has attached to Inter-City's unsecured debentures. Dr. Cannon felt this difference to be significant, especially since ratings assigned to Norcen put its securities in the investment-grade class while ratings assigned to Inter-City put its debt securities in the speculative category with, at best, only limited long-term protective investment characteristics. Dr. Cannon came to a similar conclusion when examining the preferred share ratings of Inter-City and Norcen.

Dr. Cannon calculated seven financial ratios as standard measures of the performance of a company for each of Inter-City and Norcen as at September 30, 1984 (see Appendix B). He concluded that, because all seven of Inter-City's ratios

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were poorer than Norcen's, Inter-City is a financially weaker company than Norcen.

During cross-examination, Mr. Graham, Mr. Marriott, Mr. Lackenbauer and Mr. Venn all agreed that Inter-City is a financially weaker company than Norcen but did not concede that this affected Northern in any pejorative way.

Inter-City's Ability to Raise Capital

Mr. Graham claimed that Inter-City has no problem in raising debt or equity, and stated that Inter-City intentionally utilizes as much leverage as possible.

Dr. Cannon however questioned Inter-City's ability to raise capital in the future. He cited the testimony of Mr. Venn in the most recent Northern rate hearing (E.B.R.O. 399 at p. 36) in which Mr. Venn stated that:

"perceived credit quality is critical to ensure continuous access to capital as required by a utility. While companies of "BBB" credit quality can finance in the current markets, there have been periods over the last three years when a new debt issue rated "BBB" or even "A" could not have been sold at any reasonable yield. In my opinion, in order to ensure access to capital as required,

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the allowed return on equity must be adequate to generate a credit standing of "A" in the context of today's volatile capital markets."

Dr. Cannon cited the September 1983 rating in which CBRS gave a B+(low) to Inter-City's senior debt obligations, and a B(low) rating to its unsecured debentures. These were, to the best of Dr. Cannon's knowledge, the lowest ratings assigned to any publicly-traded utility company in Canada. Dr. Cannon concluded that these ratings were too low to ensure Inter-City's continued access, on reasonable terms, to financing in Canadian capital markets. However, Inter-City testified that this 1983 rating of the senior debt obligations and unsecured debentures had been retracted because these obligations had been paid off prior to the rating. The 1983 preferred share rating still applies.

Dr. Cannon compared Inter-City's most recent key financial ratios (Appendix B) to DBRS standards. He concluded that, with the exception of cash flow as a percent of current liabilities, Inter-City's ratios did not meet DBRS Standards.

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These findings were additional proof to Dr. Cannon that Inter-City's access to external capital markets, on reasonable terms, had been impaired.

Mr. Fraser and his associates prepared a study for Inter-City which included a comparison of the ratios of various Ontario utilities and industry ratios for the year 1983.

According to this study, Inter-City's long term debt as a percentage of capitalization is the highest. In general this figure is taken to be an indicator of financial risk, the higher the figure the more risky the investment. Mr. Marriott pointed out, however, that it is difficult to compare Inter-City in this fashion because Inter-City is not a pure utility.

The pre-tax interest coverage ratio (the income before interest and tax compared to the interest charged) is, once again, a measure of risk. Inter-City's pre-tax interest coverage is the lowest of the utilities' mentioned. Mr. Venn gave evidence that, for companies in general, an interest ratio coverage of 3 or more is required by DBRS, but for utilities the required figure is

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2. It was pointed out that Inter-City's figure is less than 2, lower than the figure required for utilities. Mr. Marriott countered that the CIBC is satisfied with Inter-City's interest coverage ratio nevertheless.

MICC Investment

Dr. Cannon also testified that Inter-City's financial health is affected by its investment in MICC Investments Limited ("MICC"). This investment which totals \$38,700,000 may impair Inter-City's ability to raise capital on reasonable terms. He stated that it is widely known that MICC is in financial distress, having recently reported a \$50,296,000 loss for the 9-month period ending September 30, 1984, and that the firm's net equity capital position has fallen below the level required by the Federal Department of Insurance.

Mr. Marriott stated that no decision had yet been made as to whether there would be a write down of the MICC investment, but added that in the last interim statement, shareholders of Inter-City had been informed that the Company is considering

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making a provision against that investment at the year's end. Dr. Cannon claimed that Inter-City would not be able to do otherwise in light of the fact that similar publicly-traded securities of MICC are currently trading in the marketplace at prices which represent only a small fraction of their par values or original issue values.

Mr. Lackenbauer did not view the possible write-down of Inter-City's investment in MICC, which would reduce Inter-City's retained earnings from \$48,800,000 to \$10,100,000, as a factor of any real significance. He indicated that the market had already taken account of this.

During cross-examination it became evident that, when Inter-City invested in MICC, MICC purchased 26 percent of the issued and outstanding Inter-City common shares. This interest effectively allows MICC to control Inter-City. In evidence it was pointed out that, should MICC decide to sell its shares in Inter-City after the proposed transaction was completed, the control of Northern would be sold away as well.

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**Effect of Proposed Transaction on
Inter-City's Financial Strength**

Dr. Cannon also concluded that none of the seven financial ratios contained in Appendix B indicated that the proposed acquisition (with its associated interim or permanent financing) would improve Inter-City's financial condition. In five cases, the financial ratio values actually experienced significant deterioration. Dr. Cannon also concluded that the pro forma post-acquisition ratios were again outside the acceptable limits of DBRS credit standards.

Inter-City estimated that the after-tax financing costs of the acquisition will be \$18,300,000 (excluding any principal repayments), a sum which Dr. Cannon felt could not presently be covered by the cash generated through Northern's pro forma dividend payments to Inter-City. According to Dr. Cannon, the financing of the acquisition will create a small net cash drain on Inter-City which could, however, become much larger if interest rates (and, thus, the costs of Inter-City's new bank debt) rise.

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Inter-City's witnesses submitted that the earnings of Northern are required to service its bondholders, preferred shareholders and common shareholders in the form of dividends on the common shares calculated at \$12,500,000 in 1982, \$16,800,000 in 1983, and estimated at \$17,800,000 for 1984. They stated that Inter-City's intention was to continue Northern's present dividend policy following the acquisition. They felt the dividends would be sufficient to fund Inter-City's costs of financing the acquisition. If Northern was not able to maintain it's current dividend level, Inter-City stated it had sufficient cash flow from its other operations to meet its obligations.

Mr. Fraser noted that, subsequent to the acquisition and completion of the financing plan as proposed, Inter-City's capital structure on a consolidated basis will reflect an increased debt to equity ratio. His study showed a post-acquisition debt to equity ratio of 63 percent assuming the proposed convertible share issue has taken place and 70 percent, if the ratio was

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calculated without the convertible preferred share issue.

The pro forma statements prepared by Inter-City showed earnings per share going up by approximately 20 percent each year for the next five years while recent history shows the earnings per share decreasing on a yearly basis. Mr. Marriott pointed out that, prior to 1980, earnings had risen, and claimed that earnings would have been up in 1983 but for an extraordinary loss.

Mr. Marriott cautioned that these statements were not forecasts of what is likely to occur in the future, but rather were "models" which assume that the present state of Inter-City's operations would go unchanged. He stated however that the pro forma statements have only limited value.

THE Pursuant to a promissory note, Norcen
NORCEN presently owes Northern \$47,300,000 with an
NOTE interest rate of 7.6 percent. (the "Norcen
Note").

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The Norcen Note came into being as the result of a reorganization of Northern that occurred in 1975. When Norcen became the parent company, some of Northern's investments also moved up into Norcen and the consideration to Northern was the Norcen Note.

The Agreement states that the Norcen Note, a non-utility asset thus not included in rate base, will be transferred from Northern to Inter-City. This will be accomplished by Northern assigning the Norcen Note to Inter-City at book value, in return for which Northern will receive a note from Inter-City (the Inter-City Note) bearing identical terms and conditions to the Norcen Note.

It was also noted that the repayment schedule for Tranche B of Inter-City's loan from the CIBC is almost identical to the repayment schedule of the Norcen Note. Mr. Marriott asserted that no link exists between the proceeds to Inter-City from the Norcen Note and the repayment schedule to the CIBC, and that the loan to the CIBC can be repaid out of any of the funds available to Inter-City.

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With respect to Northern, Mr. Marriott asserted that the only change occurring is that the note will be owing from Inter-City rather than from Norcen. Dr. Cannon stated that this is a major change given Inter-City's weaker financial condition in comparison to Norcen.

Under the terms of the Agreement, should Inter-City default on its dividends or sinking fund obligations under the First Preferred Shares, Norcen has the right to offset the full amount of the interest and principal owed to it by Inter-City against the amount that Norcen owes to Inter-City under the terms of the Norcen Note. If this right of set-off is exercised, Norcen can force Inter-City to redeem all of the Series A Preference Shares. Similarly, the Agreement states that Inter-City will be given the right to offset the payment of dividends and sinking fund obligations against any possible default by Norcen on its obligations under the Norcen Note. Mr. Marriott stated that it was Norcen who asked that the right of set-off be included in the Agreement.

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Dr. Cannon characterized the changes in the Norcen Note as a loan from Northern to Inter-City. It was Inter-City's response that Northern would not be loaning money in the sense of taking cash resources available and advancing them to Inter-City for its use. Inter-City characterized the transaction as merely switching a currently existing note receivable from one company to another.

While Inter-City will accrue long term bank debt specifically as a result of the Applications at hand, Mr. Marriott stressed that the note which Inter-City will issue to Northern will be the only long term note existing on the unconsolidated Inter-City's balance sheet. It was Mr. Marriott's opinion that because of the new ranking of the note on Inter-City's balance sheet, Northern is better off being owed the money by Inter-City than it was before or at least is in no worse a position.

Mr. Lackenbauer asserted that the note was as strong with Inter-City as the promisor as with Norcen. He said that he was not "unduly troubled"

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by the note, and that he "didn't view the shift in credit as being that significant."

Mr. Venn stated that the change in promissory note would not be of major significance to investors or to the on-going ability of Northern to finance itself.

In recognition of the fact that the majority of Inter-City's assets are encumbered, Dr. Cannon did not agree with the proposition that the change in the Norcen Note would not be detrimental to Northern. He stated that the subordination of the obligations owed under the note, to the claims of Inter-City's secured creditors, would reduce the value of the assets backing up Northern's obligations to its own bondholders and preferred shareholders. He also indicated that this risk was even more pronounced because of Inter-City's weakness as a parent corporation.

Dr. Cannon indicated that the change in the note is detrimental to Northern in two ways. Firstly, Northern will be receiving inferior priority provisions under the Inter-City Note as it is subordinate not only to the debt of the unconsolidated Inter-City but also to the

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debt of Inter-City's subsidiaries. Secondly, he felt there was a possibility that the value of the note owed by Inter-City to Northern would become impaired and have to be written off against retained earnings. If this were to occur, Northern would require an extra injection of capital to compensate.

A DBRS bond rating letter of May 18, 1984 pointed out that the very existence of the Norcen Note (its term and low interest rate) was depressing the earnings of Northern. Dr. Cannon noted that these negative factors will continue to be a part of the proposed Inter-City Note.

When asked whether his concerns about the note could be alleviated in any way, Dr. Cannon stated that if the Inter-City Note was made an equal or better credit instrument than the Norcen Note, the single most important reason for the conclusion that Northern will be weakened by this transaction would disappear.

THE
ACQUISITION
PREMIUM

Mr. Marriott testified that a \$25,000,000 acquisition premium is included in the \$240,000,000 purchase price and in effect, Inter-

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City is paying \$25,000,000 over the book value of Northern's common shares. Inter-City intends to add \$8,500,000 which is carried on Northern's books as goodwill, increasing the actual acquisition premium that will be carried on Inter-City's books to approximately \$33,500,000.

Mr. Marriott contended that the premium would be partly off-set by the coupon rate on the Preferred Share issue to Norcen which is between 1 and 1 1/2 percentage points below market rates at the time the Agreement was executed.

Mr. Marriott stated that the acquisition premium would have no effect on utility rates - the premium would be carried in the investment account on Inter-City's financial statements, and would be amortized in accordance with generally accepted accounting principles. He asserted that Inter-City does not intend to write up the assets of Northern or Inter-City's existing Ontario gas distribution utility to reflect the premium.

Mr. Marriott explained that the amortization will be reflected in Inter-City's financial statements as a charge against its equity earnings in

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Northern. He explained that the premium is being amortized at Northern's overall depreciation rate of 3.5 percent in accordance with generally accepted accounting principles

POSSIBLE
CONFLICTS
OF INTEREST

ICG Liquid Gas Ltd., a wholly owned subsidiary of Inter-City, is Inter-City's principal distributor of propane gas. Mr. Graham estimated the annual sales of this subsidiary to be in excess of \$250,000,000, only a small percentage of which are generated in Northern's franchise areas.

Mr. Graham assured the Board that Inter-City would not be placed in a position of conflicting interests due to its dual role as a propane and natural gas supplier. He explained that competition does exist between the two sources of energy, but that it is not of any great magnitude because propane is economical only in very specialized markets which typically do not include residential heating fuel markets.

Inter-City also produces furnaces, and various other energy related products, through a

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subsidiary called KeepRite Inc.. Mr. Graham assured the Board that Inter-City does not presently require its utility division to distribute Inter-City's products, and that this policy would be followed by Northern should the proposed transaction be approved. Mr. Graham testified that, in effect, Inter-City would be treated by Northern in the same manner as any other supplier, having to submit to all normal tendering practices, and having to meet all normally required criteria.

**THE WINNEX
SHARES**

The Agreement stated that the Winnex shares, which according to an independent valuation as of May 1, 1984 had a fair market value of \$19,000,000, would not be included in the sale to Inter-City. The Agreement proposes that, prior to the closing of the sale of Northern, the Winnex shares would be transferred to Norcen.

During cross-examination Mr. Marriott agreed that although the Winnex shares were being exchanged at book value which is less than the fair market value, the transaction as proposed

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would result in the shares being transferred to Norcen without any actual value remaining in Northern.

According to Mr. Sheeres, it has been Norcen's intention for quite some time to obtain the ownership of Winnex from Greater Winnipeg. He did not, therefore, feel that this event should be looked upon as one resulting from the proposed transaction and that it should be viewed as an entirely independent event.

**ISSUES OF
CORPORATE
POLICY**

Corporate Reorganization of Northern

The evidence revealed that Norcen had been intending to reorganize Northern before the negotiations began with Inter-City but that the plans had been postponed pending resolution of the proposed sale. The reorganization included the removal of non-utility items from Northern and the formation of a pure Ontario utility. Mr. Graham testified that Inter-City intended to continue these reorganization plans after the closing of the transaction by applying to this Board for the necessary approvals.

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Inter-City's witnesses indicated that it had no plans to alter Northern's capitalization other than any changes which might result from the proposed restructuring of Northern and its subsidiaries. Inter-City's understanding of that restructuring proposal is that there would be no negative impact on Northern's future cost of service and rate base applications.

Northern's Board of Directors

In 1975, Norcen gave an undertaking that Northern's Board of Directors would include two members who have no involvement in Northern and who are residents of the franchise area. However, Mr. Graham explained that on the closing of the transaction, Norcen appointees to Northern's Board of Directors would resign and would be replaced by Inter-City directors, with Mr. Graham himself as Chairman. He stated that it is not Inter-City's practice to have outside directors for its subsidiaries, but that, if directed to do so by this Board, Inter-City would increase the representation from Ontario on Inter-City's Board

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of Directors, or alternatively would maintain outside directors on the Northern Board.

Management Policies

Mr. Graham indicated that Inter-City has no plans to move the management of Northern to Winnipeg. He assured the Board that the regulatory personnel of Northern would remain in Ontario. Mr. Graham indicated that the Inter-City Ontario utility interests would be consolidated with Northern's Ontario utility interests if practicable. He did not believe that this would have any effect on Northern's employment practices or on the total wage costs involved.

Inter-Corporate Loans and Guarantees

It was indicated in evidence that Inter-City does not guarantee the debt of any of its subsidiaries. Its policy is to have its subsidiaries directly finance their own operations through both long and short-term debt. However, where a subsidiary finds that it has difficulty financing its activities, or finds the cost in doing so

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excessive, Inter-City may at that point invest funds in the subsidiary in the form of debt and/or preferred and/or common stock.

Mr. Sheeres submitted that Northern is and has always been responsible for raising its own long-term debt capital. Although Norcen provides Northern with its short-term debt requirements through its own bank lines of credit, as a result of the acquisition and in conformity with Inter-City's policy, Northern has arranged a new line of credit with the CIBC. Therefore, if the acquisition is approved, he stated that Northern will become responsible for its entire debt financing. The representatives of Inter-City assured the Board that Northern would not be asked to guarantee any of Inter-City's or its subsidiaries' debt.

PUBLIC

Interpretations of the Public Interest

INTEREST

In his pre-filed material Mr. Venn gave his evaluation of how the general public interest is affected by the proposed transaction. Mr. Venn stated that:

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"it is in the best interests of the public in Ontario that transactions such as the sale of the common shares of Northern and Central from Norcen to Inter-City be permitted to proceed unless, with respect to a particular transaction, it is demonstrated that such transaction would be clearly detrimental to the public interest. There would also be a positive benefit to the public interest in having such a transaction take place after due enquiry because it would confirm that regulation in Ontario is in tune with our economic system."

Dr. Cannon's testimony provided the Board with a different test of the public interest:

"if the costs or disadvantages or detriments outweigh the benefits, then . . . my opinion would be that the transaction should not go through as it is currently structured until something is done, perhaps, to eliminate the detriments."

When asked how the Board should proceed in the hypothetical case where the proposed transaction had not been shown to have any positive or negative effect on the public interest, Dr. Cannon responded that:

"If there's absolute neutrality . . . the transaction should go ahead because I'm certainly a believer in private property rights and that one . . . corporate organization that owns an asset should, unless there is some detriment to the public interest, be able to sell it to some other corporation."

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**Effects of the Proposed Transaction
on the Public Interest**

Mr. Graham interpreted the proposed transaction as having a neutral effect on the public interest. Mr. Graham's general view was that:

"the transaction as such, will not result in savings, benefits, costs, advantages and disadvantages to the present and future customers, bond-holders and/or preferred shareholders of Inter-City or Northern and there is nothing to suggest that the proposed acquisition is contrary to the public interest or that there is any detrimental effect upon the public and its various constituents. Further, the acquisition may be viewed as being in the public interest in the sense that ownership of Northern will remain vested in a Canadian corporation that is experienced in and that possesses a proven record of efficient utility management."

With respect to Northern and its customers, Mr. Graham stated that no real advantages or disadvantages would result from the proposed transaction.

He indicated that the acquisition would result in a significant increase in Inter-City's earnings and, therefore, an increase in earnings per share for Inter-City's current common share-

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holders. He stated that preferred shareholders would receive no direct benefits as their shares pay a fixed dividend by definition, however, the increased earnings will provide increased coverage for these dividend payments. Mr. Graham also stated that the acquisition would provide Inter-City and its shareholders with greater stability in earnings, which would compensate for the risks associated with financing the acquisition.

Witnesses for Inter-City, Northern, and Norcen stated that they do not believe that the proposed transfer of ownership would have any detrimental impact on Northern's financing capabilities, or on the interests of its creditors and preferred shareholders.

It was Dr. Cannon's opinion, upon weighing the various interests involved, that the proposed transaction would not amount to mere neutrality.

He stated that:

"As the proposed acquisition is currently structured its completion would most decidedly weaken Northern and the security of its external bondholders and preferred shareholders and comprise its access to new external funding on

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favourable terms. The proposal for Northern to accept a \$47,300,000 unsecured note from Inter-City, in exchange for a similar note due from Norcen, is the single most significant reason for my conclusion . . . (As well) Inter-City is less capable of coming to the financial aid of Northern, through loans, loan guarantees, or new equity infusions, should Northern find itself facing either generally difficult financial market conditions or a situation of financial distress, or should Northern be in need of additional funding for whatever reason."

Dr. Cannon submitted that while there may be some increase in earnings per share to Inter-City's common shareholders, the additional financial risk introduced by the transaction would likely outweigh this benefit. He stated that the position of Inter-City's unsecured creditors and preferred shareholders who cannot expect to share in any earnings benefit would be adversely affected.

Proposed Conditions Precedent to Approval

Dr. Cannon, who was critical of the proposed transaction as not being in the public interest, recommended that the Board should, in whatever way is appropriate, try to get a firm undertaking from

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Inter-City that it will reorganize Northern along the lines of Northern's proposed internal reorganization. He concluded that the Ontario utility operations would therefore be a separate legal entity containing only Ontario utility assets and liabilities. He stated that the new Ontario utility should not guarantee the debt of its parent organization or any of the parent's subsidiaries and should not lend money to the parent organization or to any of the subsidiaries of the parent.

Dr. Cannon stated that from a regulatory point of view there are perceived advantages to having a regulated utility as a separate legal entity because a hypothetical capital structure would not be necessary.

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**CHAPTER 5: THE SUBMISSIONS OF COUNSEL
AND INTERVENORS**

**SUBMISSION ON The Board's Mandate
BEHALF OF
INTER-CITY**

Inter-City submitted that:

1. Section 26 directs the Board to hold a hearing and provide its report and opinion on the proposed acquisition to the Cabinet but gives no criteria to be used to measure the merits or otherwise of the proposed transaction. The Board is left on its own to develop the appropriate test to be utilized in coming to its own opinion and it is implied that their report and opinion will also include a recommendation to the Cabinet.
2. The report and opinion of the Board, as in the proposed take-over of Union Gas Ltd. by The Consumers' Gas Company Limited, should be based upon consideration of the implications of the proposed transaction on the public interest.
3. The public interest is appropriately embraced by:
 - a) the present and potential shareholders of the companies involved;
 - b) the present and potential ratepayers, that is, customers of the gas distributor;
 - c) the present and potential employees of the distributor;
 - d) the companies themselves;
 - e) the communities served by their distributors;
 - f) the investors in the companies other than shareholders; and
 - g) the public interest generally.
4. The public interest, generally, is broad enough to embrace the ability of any person, including a corporation, to acquire and dispose of capital property.

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5. If the transaction is not contrary or detrimental to the specific constituents of the public interest or to any identifiable element of the public interest, to refuse the transaction would be contrary to the public interest.

Financial Matters

- A. With respect to the "Strong vs. Weak Parent" issue, Inter-City submitted that:
 1. Although Inter-City is relatively weaker than Norcen, both immediately before and immediately after the proposed transactions, the existence of or identity of a parent, weak or strong, is irrelevant in this case.
 2. Northern is managed, operated, financed and regulated on a stand alone basis and the changeover in ownership will have no impact on Northern's ratings. In fact, Northern's bond rating is now higher than Norcen's.
 3. The favourable banking proposal that was put to Northern by the CIBC, for both its credit line and for expansion into Blind River, was made on the basis that the transaction will proceed as contemplated.
 4. Inter-City itself has been able to arrange favourable financing with the CIBC and has received an indication from its financial advisors that it will be able to successfully market a \$65,000,000 issue of convertible preferred shares.
- B. With respect to the "Norcen/Inter-City Note", Inter-City submitted that:
 1. The effect of the proposed transaction in this area is to change the obligor on

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the note from Norcen to Inter-City. This should not be of concern.

2. Under Northern's proposed reorganization, which Inter-City intends to carry out, the Norcen/Inter-City Note would be clearly, cleanly and legally removed from the Ontario utility.
3. The proposed reorganization is consistent with what Inter-City has carried out in its existing utility division.

C. With respect to "Northern's Need for Capital", Inter-City submitted that:

1. Northern's capital expenditures will be approximately \$117,000,000 over the next five years.
2. According to the "financial model" for the years 1985 to 1989, no external financing will be required for this growth.
3. Inter-City is willing to provide equity capital to Northern if needed, or alternatively, to allow Northern to go to the public market for equity capital.
4. Northern will be able to attract debt capital on terms as favourable as it could if Norcen remained the parent.

Other Matters of Concern

Inter-City submitted that:

1. There will be no changes as a result of the proposed transaction in Northern's:
 - a) management and operating practices and policies;
 - b) gas supply arrangements;
 - c) cost of gas;

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- d) number of employees in Ontario (both management and operating); and
- e) service to existing communities.

Therefore, there will be no detriment to the public interest in any of these areas.

- 2. Changes might be made in the future if they would be positive and for the benefit of Northern.
- 3. Northern will expand service to new communities where it is economically feasible to do so, and the provision of propane service by Inter-City will not inhibit expansion.

The Proposed Alternatives

Inter-City submitted that:

- 1. An outside guarantee of the \$47,300,000 Inter-City Note would cost, at least, one half of one percent per year. This would be approximately \$230,000 per year for the years 1985-1988 inclusive and would decrease each year after that.
- 2. It is not reasonable to ask Inter-City to incur that cost on the basis of a perceived weakness in the Inter-City Note as compared to the Norcen Note.
- 3. As an alternative, Inter-City would hypothecate, to a trustee for Northern, Inter-City's equity of redemption in the Northern shares as collateral security for the note. These shares will be pledged under the hypothecation and loan agreement to the CIBC. Therefore, if there was any realization by the bank on the shares, any surplus over and above what was owing to the bank would be delivered to the trustee for the account of Northern.

4. This hypothecation would be retracted if and when the proposed reorganization of Northern was completed.
5. Inter-City will have the Inter-City Note rated by one of the bond rating agencies and will advise the Board of the rating.
6. Inter-City will investigate the possibility of rolling its existing Ontario operations into Northern's Ontario utility operations.

Agreement Extension

Inter-City submitted that:

1. The parties have verbally agreed that, should the proposed transaction not be approved by December 31, 1984, the closing date will be extended to "as soon as practicable after November 30, 1984".
2. Inter-City will compensate Norcen for the delay after December 31, 1984 by paying interest at the CIBC prime rate (on the \$163,000,000) on a daily basis for any period from January 1, 1985 to the date of closing.

Conclusions

Inter-City submitted that:

1. With respect to the specific constituents of the public interest, the effect is neutral. There are no direct perceivable benefits and no direct perceivable disadvantages.
2. There may be long term positive results with respect to the inclination to provide equity to Northern if required, and the aggressiveness with which any expansion would be undertaken.
3. It is not reasonable to ask Inter-City to guarantee the Inter-City Note.

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4. The proposed reorganization should not be a condition of approval.

SUBMISSION ON BEHALF OF NORCEN

The Board's Mandate

Norcen submitted that:

1. Under Section 26, the Act does not indicate the considerations to which the Board should have regard in preparing its report and opinion for submission to the Lieutenant Governor in Council.
2. The definition of the public interest is adequately set out in the Board's Procedural Order.
3. A property owner should be allowed to dispose of its property unless it is established that such disposition would be detrimental to the public interest.

Financial Matters

- A. With respect to the "Strong vs. Weak Parent" issue, Norcen submitted that:

1. Northern, on a stand alone basis, both before and after, becomes a subsidiary of Inter-City, and will be able to meet its own capital requirements in the foreseeable future.
2. There is a strong likelihood that the proposed transaction will have no effect on the DBRS or CBRS ratings of securities of Northern.
3. The CIBC proposed line of credit and funds for the Blind River project are on extremely advantageous terms and constitute strong evidence that the financial community does not perceive any lessening in the credit quality of Northern as a result of it becoming a subsidiary of Inter-City.

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4. The fact that certain institutional holders of first mortgage bonds of Northern refused to give necessary consent to the proposed transaction should be viewed as an opportunistic move and not a concern with the change in parent.
5. Northern, being a regulated company, could not agree to an increase in the interest rate paid on its securities in order to facilitate a transfer of its common shares from one company to another.

B. With respect to the "Norcen/Inter-City Note", Norcen submitted that:

1. The Inter-City Note is of equal or better quality than the Norcen Note because the Norcen Note is junior to all other existing debt of Norcen.

Other Matters of Concern

Norcen submitted that:

1. The sale of the Winnex shares should not be an issue in the Board's consideration. Not only are the Winnex shares not part of the regulated utility assets of Northern, but this transaction had been planned before Inter-City and Norcen commenced discussions for the sale of the common shares of Northern and will be completed in the near future whether or not the common shares are sold to Inter-City.
2. The perceived conflicts of interest between natural gas and propane have been satisfactorily dealt with and the Board should have no concern in this area.
3. The present management policies and procedures of Northern will not be changed as a result of the change in ownership.

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The Proposed Alternatives

Norcen submitted that:

1. The proposed reorganization, in which all liabilities and assets of Northern which cannot form part of the Ontario utility system (including the Inter-City Note which replaces the Norcen Note) will be removed from Northern's capital structure, is currently on hold due to the proposed sale of Northern to Inter-City.
2. It is Inter-City's intention to proceed with the proposed reorganization.

Conclusions

Norcen submitted that:

1. Norcen's acquisition of a minority interest, through its acquisition of certain First Preference Shares of Inter-City, has by itself no effect on the public interest.
2. The proposed sale of the common shares of Northern to Inter-City will not result in any detriment to the public interest.
3. The Board should recommend to the Lieutenant Governor in Council that Norcen should be permitted to sell the common shares of Northern to Inter-City in accordance with the terms and conditions of the Purchase and Sale Agreement.
4. If the Board considers that the public interest would be served by having Inter-City give certain undertakings along the lines of those given by Norcen and its predecessor company in 1975 (see Appendix C), or otherwise, the proposed undertaking should be referred to in the Board's report and opinion, and the details should be worked out in due course between Inter-City and appropriate officials in the Ministry of Energy.

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SUBMISSION ON
BEHALF OF
SPECIAL
COUNSEL

The Board's Mandate

Special Counsel submitted that:

1. The Board is empowered to review the Applications under Section 26 of the Ontario Energy Board Act.
2. The Board's mandate is to hold a public hearing and submit its report and opinion to the Lieutenant Governor in Council who exercises a discretion to grant or refuse an Applicant the right to conclude a transaction as defined in the Act.
3. The power vested in the Board and the Lieutenant Governor in Council under the Act ought to be exercised in the public interest even if these words are not expressly used in the section of the Act under consideration. The public interest has been defined to mean the general public interest in the broadest possible sense unless the Legislature expressly or by implication narrows its scope.
4. The public interest is agreed to be as defined by the Board's Procedural Order.
5. The Board, in rendering its opinion, ought properly to weigh the various public and private factors and interests led in evidence at the public hearing with a view to accommodating the overall public interest.
6. Further the Board ought to recommend refusing a transaction only if the general public interest is on balance detrimentally affected. Any other view of the Board's mandate would be contrary to the right of persons to acquire and sell property and therefore an unwarranted interference in an open economic system.
7. If the transaction is on balance neutral, the Board ought to recommend that leave to complete the transaction be granted.

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Financial Matters

A. With respect to the "Strong vs. Weak Parent" issue, Special Counsel submitted that:

1. Inter-City is financially a much weaker corporation than Norcen and has consistently been so over the past two years. This was evidenced by:
 - a) Dr. Cannon's financial ratio analysis (which should be accepted without qualification because his formulas were consistent with DBRS, CBRS, Richardson Greenshields and the CIBC);
 - b) the fact that Norcen's bond rating is higher than Inter-City's bond rating;
 - c) the fact that Inter-City has a \$38,700,000 investment in MICC which may have to be written down because MICC is in serious financial difficulty.
2. Inter-City's financial condition is such that its access to external bond and preferred share markets on favourable terms is jeopardized. Therefore, Inter-City's financial condition is weak in absolute terms.
3. Inter-City is an even weaker company after the proposed purchase of the Northern common shares than before. The additional financial risk to Inter-City created by borrowing \$163,000,000 to purchase the Northern common shares outweighs the benefits to Inter-City of having an increase in its consolidated net profits, particularly from the viewpoint of Inter-City's external creditors and preferred shareholders.

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4. The parent of a subsidiary corporation is important. The weaker financial condition of Inter-City, as compared to Norcen, will affect the ability of Northern to raise capital continuously on favourable terms.
5. The only bondholders of Northern who were in law entitled to react to the proposal under the first trust indenture, refused to consent to the transaction. These bondholders preferred Norcen rather than Inter-City as the parent company.

B. With respect to the "Norcen/Inter-City Note", Special Counsel submitted that:

1. The financial weakness of Inter-City will affect Northern's ability to raise external capital on reasonable terms and hence is detrimental to the public interest. This detriment will be further accentuated by the existence of the Norcen Note.
2. The Norcen Note, which is essentially a demand note, has a present value of \$47,300,000. The Inter-City Note has a present value of \$24,900,000.
3. The Inter-City Note is not more secure than the Norcen Note. The evidence shows the opposite. The liabilities and shareholders' equity ranking after the Norcen Note are equal to 49.8 percent of Norcen's total assets. The liabilities and shareholders' equity ranking after the Inter-City Note are equal to 49.7 percent of Inter-City's total assets. Therefore, the positioning on the balance sheet does not really change and the fact that Inter-City is financially weaker makes the Inter-City Note less secure.

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Other Matters of Concern

Special Counsel submitted that:

1. The potential conflicts of interest between natural gas and propane and the manufacture of oil furnaces and gas sales should not affect the Board's opinion.
2. There will be no detriment to Northern's employees as a result of the proposed transaction.
3. The acquisition premium will not be put into Northern's rate base and will have no impact on the rates of Northern's Ontario customers.
4. The overall effect of the sale of the Winnex shares is that the asset owned by Greater Winnipeg is transferred from that company through Northern and into Norcen without any money remaining in the Northern group in exchange. However, this transaction has been planned for some years and, if it is not of itself improper, ought not to affect the Board's deliberations in any way.
5. The pension fund proposal ought not to be a negative factor to be considered in the Board's deliberations.

The Proposed Alternatives

Special Counsel submitted that:

1. Inter-City ought to reorganize Northern along the lines of the proposed corporate reorganization set out in Exhibit 25.
2. The Ontario utility system should be set up as a separate legal corporate entity which will:
 - a) have only Ontario utility assets and appropriate corresponding liabilities

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(i.e. the asset side of the balance sheet would not contain the Norcen/Inter-City Note);

- b) in no way guarantee the obligations of the parent organization or any of the parent's subsidiaries and will not loan money or carry any loans on its balance sheets to any parent organization or to any subsidiaries of the parent;
- c) be required to raise its own short-term financing along the lines of the proposed line of credit offered to Northern by the CIBC;
- d) have debt to equity ratio guidelines, with actual common equity capital at each fiscal year's end being required to be no less than 2 percentage points (of long-term debt plus preferred shares plus common equity) below the equity ratio approved at the most recent rate hearing;
- e) be given the ability, through appropriate amendments to the trust deeds, to raise its own debt and equity funds; and
- f) have its own Board of Directors, several of whom should be outside Directors and have some regional representation.

3. Prior to the time that this reorganization is effected, Inter-City should provide a chartered bank guarantee for payment of the note to Northern.
4. The reorganization must have the approval of the Board. One important issue to be considered is whether the proposed reorganization ought to be completed prior to the transactions under review being approved.
5. The terms of the Order-in-Council imposed upon Northern and Norcen should be continued to the extent that they remain relevant. In particular, Inter-City should not take excessive dividends out of Northern and should be required to supply equity capital as needed.

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6. The Inter-City Ontario utility assets should be amalgamated with the new separate Ontario utility company.
7. The regulatory personnel for the Ontario utility system should remain in and operate out of Ontario as is currently proposed.

Conclusions

Special Counsel submitted that:

1. There are no foreseeable savings, benefits or advantages to the public interest arising from the proposed transactions.
2. The potential benefits as described by Mr. Graham are speculative and have not been supported by any studies or evidence presented.
3. The Norcen Note transaction, and the fact that Inter-City is a weaker credit than Norcen, each alone and together, are substantial enough detriments that they may affect the ability of Northern to continuously attract capital at reasonable rates now and in the future. These factors may affect the rates of the present and future customers of Northern and the security of its present bondholders and preferred shareholders.
4. The Board should recommend that the Lieutenant Governor in Council refuse the Application of Inter-City, Resources and Vigas. The Application of Norcen stands or falls with the outcome of the first Application.
5. The Board may wish to consider recommending that the Lieutenant Governor in Council issue an Order-in-Council:
 - a) requiring Inter-City, Resources and Vigas to fulfill certain plans and meet certain criteria (set out under Special

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Counsel's proposed solutions in this chapter) as a condition of any approval;

b) inviting the Applicants to re-apply after the changes outlined have been completed by Norcen, Northern and other related companies, so that Inter-City can re-apply to purchase the Northern common shares without the Norcen Note being in a position to affect the utility assets of Northern and at a time when the Ontario utility would be acting on its own.

6. The Board ought to render its opinion to the Lieutenant Governor in Council so that His Honour requires the Board to review in detail any proposed changes in Norcen and Northern or in Inter-City, Resources, Vigas and Northern depending on whether His Honour exercises his discretion to grant a conditional approval or whether His Honour rejects the Applications with leave to the Applicants to re-apply after the appropriate changes in the companies and transactions have been completed. This requirement arises because the Board has been given only a cursory view of the proposed reorganization of Northern and the acceptability of the reorganization from the perspective of the public interest.

Costs

Special Counsel submitted that:

1. The costs of and incidental to any proceeding before the Board are in the sole and unfettered discretion of the Board. The costs of the Board and Special Counsel ought to be assessed against the Applicants.
2. With respect to the costs of FONOM, their participation was substantial.

The Board's Mandate

FONOM submitted that:

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1. The Act provides no explicit guide as to what the test should be under Section 26.
2. The Act, through its general scheme, however, suggests that both the Cabinet and the Board, under Section 26, must determine whether this transaction is in the public interest.
3. The Cabinet is involved so that there is a political accountability for the decision reached. The Board is involved to ensure that everyone who deserves the right to be heard in a full and fair manner, and the right to have his or her views considered when a determination is made, will receive his or her right accordingly.
4. The public interest includes:
 - a) the present and future customers of natural gas, including residential, commercial and industrial users;
 - b) the remaining people of Ontario who do not use natural gas; and
 - c) those people who do not use gas directly but who consume products made by industrial gas users.

The shareholders' interests are not an element of the public interest.

5. The relevant questions to be asked when defining the Section 26 test are:
 - a) Will the ability of the system to provide a secure supply of natural gas to present and future customers at the lowest possible cost be enhanced or lessened, on balance, by this transaction?
 - b) Will the availability of a strong natural gas delivery system as an energy source for the people of Ontario, be enhanced or reduced, on balance, by this transaction?

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6. If the answer to both questions is yes, then the Board's opinion should favour the transaction. If the answer is negative, then the Board should oppose the transaction.
7. If the Board arrives at a neutral balance, the Board's opinion should be that the take-over should be allowed; a willing seller should be able to sell to a willing buyer subject to such conditions as the Board might wish to impose.
8. The onus of meeting the test lies with the Applicant who wishes to change the status quo.

Financial Matters

- A. With respect to the "Strong vs. Weak Parent" issue, FONOM submitted that:
 1. The fact that Inter-City is a weaker parent company than Norcen is an important factor to be considered, particularly if it should ever become necessary for Northern to look to its parent for a further infusion of equity.
 2. The fact that the Northern first mortgage bondholders fled to Norcen when they learned that Inter-City was to be the new parent supports the position that the weaker parent is a significant factor.
 3. The fact that the CIBC is willing to fund the debt portion of this transaction does not upset the action by the first mortgage bondholders. CIBC is willing to loan the money to Inter-City because it will have significant collateral security for the loan, namely all of the common shares of Northern.
 4. Norcen itself has taken precautions, in the form of unusual set-off arrange-

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ments, against the possibility of Inter-City experiencing difficulties.

5. The CBRS bond rating agency is less enthusiastic about Inter-City than about Norcen, leading to a potentially higher cost of capital to Northern.

B. With respect to "Northern's Need for Capital", FONOM submitted that:

1. The estimated cost to Inter-City of funding the proposed take-over (\$18,300,000 after tax, in interest and dividends alone) is expected to be covered by the dividends anticipated to be paid by Northern to Inter-City. There is reason to believe this may not be the case.
2. If general interest rates continue to fall as inflation subsides, the rate of return allowed to shareholders of Northern will decline. Thus, the net income of Northern will also decline. This will place an increasingly greater pressure on Inter-City to increase the dividend pay-out ratio of Northern, in order to continue to fund the purchase transaction. This will leave Northern with little or no retained earnings to increase its equity base or to fund continuing growth.
3. Inter-City, because of its own financial weakness, will be unable to make up any shortfall in funding required by Northern.
4. There is a substantial risk that Inter-City will come under strong pressure to bleed off the net income of Northern in future years.
5. The unfortunate difficulties of MICC, in which Inter-City has a significant

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interest, will increase Inter-City's financial weakness. That the Board of Directors of Inter-City will play a very active role in managing the affairs of Northern is disturbing, especially considering that six out of eleven members of this Board are Directors of MICC.

Other Matters of Concern

FONOM submitted that:

1. The highly centralized control of subsidiaries at Inter-City's head office in Winnipeg may result in a lack of awareness of the Ontario system's needs.
2. The loss of Northern Ontario representatives on Northern's Board of Directors will be a detriment.
3. It is difficult to assess the potential conflict of interest between Inter-City's gas and propane operations.

The Proposed Alternatives

FONOM submitted that:

1. The ultimate disposition of significant non-utility assets such as the Norcen/Inter-City Note is important and thus the proposed reorganization is not necessarily an appropriate alternative.
2. The institutional investors and the public look to the whole corporate structure to determine the ability to finance unserviced debt and equity. Therefore, the corporate income stream in total is of utmost importance.
3. The following undertakings, outlined in the Order-in-Council of July 30, 1975, should be continued:

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- a) annual review of present and future gas supply positions of Northern by the Minister;
- b) prior notification of any change of control of the parent;
- c) obtaining exemptions from a requirement to issue equity capital under the Alberta Gas Utilities Act, if applicable;
- d) retention of an appropriate portion of earnings in Northern, and, to the extent that retained earnings are not sufficient to maintain equity at a suitable level to carry on the gas distributing business, the parent is to supply equity capital; and
- e) repayments by the parent to Northern as stipulated under the demand note to Northern.

4. The following undertakings given by Norcen to the Minister in 1975 show that the Minister and the Ontario Cabinet were concerned about the future health, control and financial management of Northern and Central Gas. For this reason, these undertakings should be continued.

- a) Executive Officers of the parent were to be located in Toronto;
- b) Norcen was to obtain an extra-provincial license under part 9 of the Ontario Corporations Act and file returns as required; and
- c) The Board of Directors of Northern was to include two residents of the areas served by Northern having no pecuniary interest in the company and not connected with the company producing or transmitting natural gas,

Conclusions

FONOM submitted that:

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1. There are no benefits to the public interest arising from the proposed transaction.
2. The financially weak condition of Inter-City and the presence of the Inter-City Note suggest the potential for a significant change in Northern's access to capital markets and its cost of borrowing.

Costs

FONOM submitted that:

1. The Board has a broad discretion in the awarding of costs to intervenors. This Board has set out four criteria for the granting of costs. An award of costs should be made to respondents who:
 - a) have asked for them;
 - b) have a substantial interest in the outcome of the proceedings;
 - c) have participated in a responsible way; and
 - d) have contributed to a better understanding of the issues by the Board.
2. FONOM has met these four criteria.
3. A further policy of the Board in the past has been to grant costs only in unusual and special circumstances. This hearing constitutes an unusual and special circumstance.
4. The cost of this hearing, including FONOM's costs, should not be borne by the gas consumer but by the shareholders of the applicant company, who, alone, stand to gain from the proposed take-over.

**REPLY BY
INTER-CITY**

Costs

Inter-City submitted that while it is difficult to object, it does not consent to any awarding of costs. Should costs be awarded,

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however, they should be dealt with by way of an agreement between the parties.

**REPLY BY
NORCEN**

Costs

Norcen adopted Inter-City's submission with respect to costs.

Norcen Note

Norcen submitted that:

1. The Inter-City Note is a demand note as it is identical in form and terms to the present Norcen Note.
2. An amount of debt equal to 32.2 percent of the total assets does not rank equally with the Norcen Note. All Norcen debt ranks ahead of the Norcen Note.

The Proposed Alternatives

Norcen submitted that:

1. It will take a considerable amount of time to effect the proposed reorganization.
2. An income tax ruling on the proposed reorganization, which Norcen has been trying to get for over six months, is required.
3. The consent of all external bondholders to the proposed reorganization is also required.
4. Special Counsel's suggestion that actual common equity capital at each fiscal year's end should be required to be no less than 2 percentage points (of long term debt plus preferred shares plus common equity) below the equity ratio approved at the most recent rate hearings is difficult to understand. The Board should not make an Order that would have to be negotiated due to an inability to understand the terms.

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CHAPTER 6: FINDINGS OF THE BOARD

INTRODUCTION

This chapter contains a description of the Board's mandate in regard to the public interest and its opinion of the Applications based on the evidence outlined in the earlier chapters along with certain findings of fact. Together with this evidence, the Board has taken into account the submissions of the parties, the rights of individuals and companies to make private contracts and the public interest generally.

PUBLIC

INTEREST

Although Section 26 of the Act does not refer to the public interest or, for that matter, to any other considerations the Board is to use in arriving at its opinion of this transaction, the Board considers that the public interest is of paramount consideration. The question then arises, "what is the public interest?"

In searching the case law on the point, the Board has found literally hundreds of cases in Canada and the United States in which courts or administrative boards have employed the test of

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public interest in a variety of factual situations. The location of highways, pipelines and transmission towers, the granting of radio licences, natural gas franchises and trucking permits have all been based on the test of the public interest in one sense or another. The wide variety of cases in which it has played some part in a decision, effectively means that the findings of those tribunals do not lend themselves to a clear codification. In fact, just defining what "public" the interest refers to, is difficult in itself. A "public" opposed to the building of a nuclear reactor seldom represents all the "publics" affected---it does not speak for the construction unions or the mine workers, it does not speak for the investors in the station or even all the consumers, but the "public" presenting its views, still purports to represent the "public".

Of the public interest, Mr. Justice Holmes said: "We mean, of course, considerations of what is expedient for the community concerned." Many other legal theorists have left behind similar quotations, but because of the diverse

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applications to which the words "public interest" have been applied, there is not a single, simple explanation of sufficient clarity to be particularly helpful.

In its Procedural Order the Board outlined the public interest for the purposes of this hearing to be the benefits and detriments to:

1. present and potential shareholders, investors and Ontario customers of Northern;
2. the shareholders and Ontario customers of Inter-City;
3. the Ontario communities served by Northern and Inter-City;
4. securing natural gas transmission, storage and distribution at reasonable cost to consumers in Ontario; and
5. the public interest generally.

These general parameters have been used in the past by the Board although a specific test of the public interest has never been delineated.

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In the opinion of the Board, the public interest can only be more particularly defined by examining the facts and nature of the situation in which the test is to be used. The public interest will consistently take the form of the facts to which it is applied, moulding itself to the specific use to which it is being put.

Having determined that the public interest is not generally definable, the Board would add that, in spite of its elusiveness, when it is applied to a specific set of facts, the reasonable man of the Common Law has no trouble determining if a particular act meets the test. A transmission tower, by this test, might be located in a productive, peaceful countryside, in spite of the residents' objections if the tower is found to be in the public interest of a nearby population centre. The public interest of the urban residents may be said to outweigh the local interests of the rural public in those circumstances.

Lord Coke put it succinctly when he wrote:

"The law prefers the public good to the private good and that if it has

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to choose between prejudice to the many and mischief particular to individuals, the individuals must suffer."

The broader social concept of public interest has lurked beneath the Common Law even in its earliest formative period and the Board's duty now is to apply it to the facts of this case.

In the regulatory context of the transaction presently before the Board, the public interest is not served if Northern, following the sale, is unable to serve the public, except at unreasonable prices. Alternatively, it follows that the public interest is served if those who want the utility's services obtain those services at rates which are not adversely impacted by the transaction. While a checklist of value conflicts is impracticable, it is possible to derive specific questions related to the facts of this case, the answers to which are essential to the Board in its consideration of the public interest:

1. Can Northern continue to meet its obligations to serve present and future customers without unreasonable

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conditions of service and rates caused by the sale of its shares?

2. Can Northern maintain itself in a sound financial condition so that the public can continue to be served, in the short and long term, in a manner which will contribute to the public's general well-being?

OPINION

In considering the evidence, the Board is of the opinion that the transaction, as presently structured, is not in the public interest. However, with the provision of a guarantee from a chartered bank for the Inter-City Note, and with certain undertakings being given by Inter-City, it is the opinion of the Board that the transaction would meet the test of the public interest and therefore the Board would recommend it for approval by the Lieutenant Governor in Council.

It was generally agreed by all parties that Inter-City is not as strong as Norcen. In fact, the Board is of the opinion that without certain safeguards Inter-City is not sufficiently strong

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to allow Northern to maintain its ability to meet its commitments to its customers at a reasonable cost. Necessary equity injections for Northern and the maintenance of an acceptable dividend payout ratio are important factors considered by the Board to be benefits of a strong parent company. As well, the Board is concerned about the potential of unsecured inter-corporate loans between Northern and its proposed parent.

The Board recommends that Inter-City enter into certain suitable undertakings and that the undertakings should contain, as a minimum, provisions whereby:

1. Inter-City will cause such portion of the earnings of Northern to be retained as is appropriate for retention by a gas distribution utility, and to the extent that such retained earnings are not sufficient to maintain the equity of Northern at a level sufficient to enable it to carry on its business of distributing gas in Ontario, Inter-City will provide additional equity capital sufficient for that purpose, on terms

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at least as favourable as Northern could have obtained directly from the market itself;

2. Inter-City will not cause or permit Northern to enter into inter-corporate loans or loan guarantees with Inter-City or its subsidiaries;
3. Inter-City will permit Northern to raise its own equity capital in the marketplace if necessary and if Inter-City is unable to provide the same itself;
4. Northern's head office will remain in Ontario and will function in all normal respects as the head office for the Ontario utility operations;
5. Northern will maintain on its Board of Directors at least two residents of its franchise area who have no pecuniary interest in Inter-City consolidated or any other natural gas distribution, transmission, exploration or production company;
6. Inter-City agrees to apply to this Board forthwith for approval of the corporate reorganization of Northern;

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7. Until such time as the proposed restructuring of Northern is approved by this Board and lawfully effected in accordance with the Board's approval, Inter-City will, at its expense, cause the Inter-City Note (which is to replace the Norcen Note presently on Northern's balance sheet) to be guaranteed by a Canadian chartered bank; and
8. Inter-City agrees that it will provide timely prior notification to the Lieutenant Governor in Council of any development or occurrence of which Inter-City has knowledge or information, by which control of Inter-City could be acquired by any other person or corporation.

Provided that the above undertakings are met, and the sale of the Northern shares to Inter-City is permitted by the Lieutenant Governor in Council, the Board recommends that the issuance of the Inter-City Preference Shares to Norcen be approved by the Lieutenant Governor in Council as it meets the test of the public interest for the following reasons:

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1. the acquisition is a minority interest in Inter-City and has no effect on the public or on the control of Inter-City; and
2. the substance of the Agreement is the sale of the Northern shares which, if approved by the Lieutenant Governor in Council, requires the issuance of these Inter-City shares to Norcen.

REASONS FOR Strength of Parent

OPINION

The above opinion of the Board is based upon the evidence and the following findings of fact by the Board, including the financial strength of Inter-City and the effect of that strength on Northern. The Board is of the opinion that in the case of Northern the strength of its parent is important, and for the following reasons the Board finds as a fact that Inter-City is financially weaker than Norcen:

1. All financial ratios indicated clearly that Inter-City is weaker than Norcen;
2. The reaction of Northern's first mortgage bondholders indicated that they considered

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Norcen to be financially stronger than Inter-City;

3. Norcen's right of set-off of the \$47,300,000 Norcen note is indicative of Norcen's desire for extra security for the balance of the purchase price paid by way of Inter-City Preference Shares;
4. The material filed in evidence with respect to both Canadian bond rating services has ranked Inter-City's securities issued, from time to time, lower than Norcen's; and
5. Inter-City's investment of \$38,700,000 in MICC may have to be written off Inter-City's books in whole or in part.

The effect of this relative weakness of Inter-City could have a detrimental effect on Northern and the public interest generally for the following reasons:

1. Inter-City's weaker financial strength may prevent it from being able to provide necessary equity to Northern if such is required;

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2. Inter-City, because of a future requirement for cash, may be forced to increase Northern's dividend pay-out ratio beyond acceptable limits and thus damage Northern's credit rating;
3. Investors may be reluctant to purchase Northern's securities if they perceive a weaker parent and thus Northern's cost of capital may increase; and
4. A weaker parent may be more inclined to enter into inter-corporate loans with Northern which may not be properly secured.

Norcen/Inter-City Note

The Inter-City Note should be removed from Northern's Ontario utility balance sheet. The terms of the note and its treatment, as presently contemplated by the Agreement, are prejudicial to Northern's future credit worthiness for the following reasons:

1. The replacement of the Inter-city note with an Inter-City note of equal terms removes the more favourable security provided by Norcen;

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2. Funds available to Inter-City for the payment of its note to Northern will be subject to a right of set-off by Norcen in event of default by Inter-City on the payment of dividends and capital on the Preference Shares held by Norcen and the likelihood is that if that occurs, Inter-City will default on its note to Northern; and
3. By the terms of the loan agreement between the CIBC and Inter-City, it has the right to assign the then present value of the Norcen Note to the bank in satisfaction of part of its indebtedness, thus removing a source of funds for Inter-City to satisfy its note to Northern.

Undertakings

The Board is of the opinion that the undertakings which form part of the Board's opinion and are outlined above are necessary for the following reasons:

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1. The ongoing stability of Northern is vital to the residents of those areas served by Northern;
2. The acquisition of Northern either directly by the sale of its shares, or indirectly by the sale of the shares of its parent company, could have a serious impact on Northern's customers and should therefore be subject to review by the Lieutenant Governor in Council; and
3. Inter-City does not intend in the normal course, to appoint any directors who are also residents of Northern's franchise area.

COSTS

Mr. Johnson, counsel for FONOM, asked that costs be awarded to FONOM, pointing out that the Board has a very broad discretion to award costs under Section 28 of the Act. No other intervenor played an active role in the proceeding.

He referred to the Northern Decision in E.B.R.O. 314-II, (November, 1977), where the Board set out the following four criteria for the awarding of costs to intervenors:

REPORT OF THE BOARD

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"Costs will be awarded to all of the respondents in this proceeding who:

- a) seek them;
- b) have a substantial interest in the outcome of the proceeding;
- c) have participated in a responsible way; and,
- d) have contributed to a better understanding of the issues by the Board."

Mr. Johnson stated that these criteria have been met by FONOM.

He mentioned that there was a "further hurdle" to be met as outlined by the Board in another Northern Decision (E.B.R.O. 364-II, July, 1980). The Board in that case found that in its opinion there must also be unusual or special circumstances to warrant the awarding of costs to any intervenor.

Mr. Johnson submitted that this requirement had been met in this proceeding because the present proposal would have a major impact on the future distribution system of Northern and that this hearing therefore constituted one of unusual and special circumstances. He stated that costs should be borne by the shareholders of the Applicants because they alone stand to gain from the transaction.

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Mr. Brett did not consent to any award of costs, but he said it "is difficult to find a strenuous argument against the awarding of costs" in this case.

The Board notes that in H.R. 5 (the Report on the Principles of Electricity Costing and Pricing for Ontario Hydro) the Board said in part that:

". . . in the opinion of the Board, views of Ontario Hydro's customers and the public in general must be considered. To this end it is important to encourage active, informed and useful participation so that a wide range of views can be examined in detail".

We agree with Mr. Johnson that the hearing was special and unusual, dealing with the transfer of ownership of Northern and its impact on the Northern Ontario community that it serves. Although the hearing was not unduly lengthy, it dealt with many complex and contentious issues. FONOM represents some five cities, 14 towns and 14 townships or districts in Northern Ontario served by Northern. There are some 117,000 residential customers of Northern in these communities so that FONOM represents the interests of the area in an important and substantial way.

REPORT OF THE BOARD

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The Board therefore concludes that not only has FONOM met the four criteria set out in E.B.R.O. 314-II, but also the test of the Board in E.B.R.O. 364-II. There were unusual and special circumstances arising out of this matter and throughout the hearing counsel for FONOM contributed to a better understanding of the issues by the Board.

The Board will therefore issue a separate Order requiring that the Applicants pay the costs of FONOM set at \$5,500.00, as well as the costs and expenses of the Board. Both sets of costs shall be borne equally by the shareholders of Norcen and Inter-City and not by their respective customers.

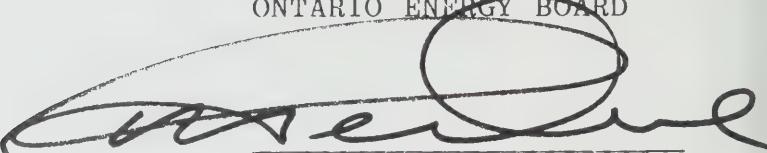
All such costs are to be payable within thirty days of the date of the Order-in-Council that will result from this report as approved by His Honour the Lieutenant Governor.

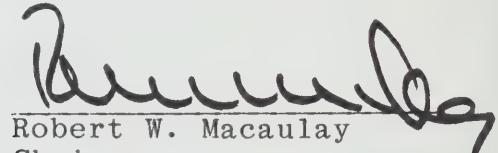
REPORT OF THE BOARD

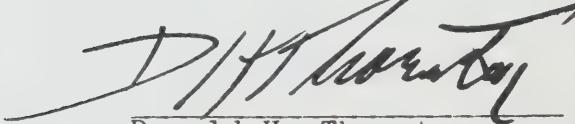
January, 1985

DATED at Toronto this 16th day of January,
1985.

ONTARIO ENERGY BOARD

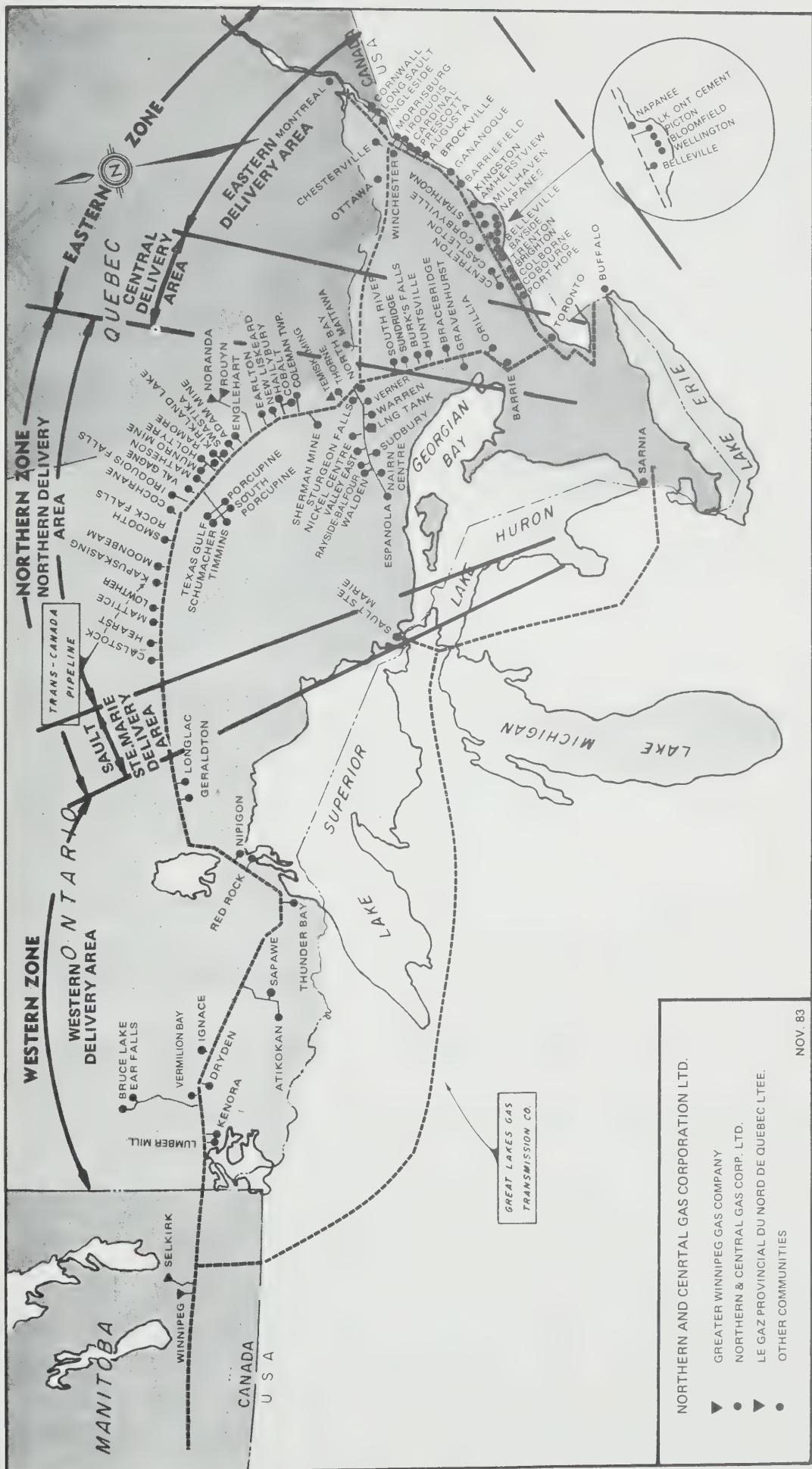

Richard R. Perdue
Presiding Member


Robert W. Macaulay
Chairman


Donald H. Thornton
Member

APPENDIX A

DISTRIBUTION NETWORK



APPENDIX B

FINANCIAL RATIO ANALYSIS

(Figures for September 1984 refer to results
for the 12 months ending September 30, 1984)

1

Pro Forma ICG Consolidated with

Northern and Central Gas Corporation Limited

For the 12 months ending September 30, 1984

Prior to Proposed

Issue of Convertible

Preference Shares

Proposed Convertible

Preferred Issue

MICC Investment

At Book Value

Written Off Fully

Consolidated
NORCEN

Consolidated
INTER-CITY
GAS

Financial Ratio¹

1 The definitional formula for each financial ratio is set out on the following page. These definitions correspond to those used by the Dominion Bond Rating Service (DBRS).

Schedule 2

DEFINITIONAL FORMULAS USED IN FINANCIAL
RATIO ANALYSIS FOR SCHEDULE 1

1. Times Interest Earned (Before-Tax Basis):

Net earnings (excluding minority interest in subsidiaries) plus taxes and all interest costs, divided by all interest costs.

2. Times Interest Earned (After-Tax Basis):

Net earnings (excluding minority interest in subsidiaries) plus all interest costs, divided by all interest costs.

3. % Total Debt in Capital Structure:

(a) The sum of all short-term debt and all long-term debt (including long-term debt due within one year) divided by (b) the sum of all short-term debt and all long-term debt (including that due within one year) plus preferred and common shareholders' equity.

4. Cash Flow as % of Long-Term Debt:

Net after-tax earnings, plus depreciation and amortization and deferred taxes, minus capitalized interest and the excess of equity earnings in subs. over dividends received, all divided by total long-term debt including that due within one year.

5. Cash Flow as % of Current Liabilities:

Net after-tax earnings, plus depreciation and amortization and deferred taxes, minus capitalized interest and the excess of equity earnings in subs. over dividends received, all divided by total current liabilities including short-term borrowings and long-term debt due within one year.

6. Asset Coverage:

(a) Total assets minus intangibles, minus all current liabilities except short-term debt, minus deferred taxes, minus minority interest, minus all other liabilities, divided by (b) the sum of all short-term and long-term debt (including that due within one year).

7. Net Profit Margin:

Net after-tax earnings before extraordinary items divided by total operating revenue or total sales revenue.

APPENDIX C

**ORDER-IN-
COUNCIL
2116/75**

The Order-in-Council, filed under Exhibit 18,
reads as follows:

"Copy of an Order-in-Council approved by
Her Honour the Lieutenant Governor,
dated the 30th day of July, A.D. 1975.

The Committee of Council have had under
consideration the report of the Honourable
the Minister of Energy, wherein he
states that,

WHEREAS Newco Limited applied to the
Ontario Energy Board for leave to be
granted by the Lieutenant Governor in
Council, pursuant to section 26(2) of
The Ontario Energy Board Act, to enable
Newco Limited to acquire all of the out-
standing voting shares of Northern and
Central Gas Corporation Limited, and the
Ontario Energy Board, after a hearing,
in its Report and Opinion, recommending
that such leave be granted, subject to
the terms and conditions hereinafter
mentioned in paragraph A;

AND WHEREAS, after consideration of the
said Report and Opinion, the Minister of
Energy initiated discussions with Newco Limited
pursuant to which Newco Limited
agreed, upon the leave applied for being
granted, to give the several under-
takings hereinafter mentioned in para-
graph B;

The Honourable the Minister of Energy
recommends that, effective on and after
July 31, 1975, leave be granted to Newco Limited,
pursuant to section 26(2) of
The Ontario Energy Board Act, to acquire
all of the outstanding voting shares of
Northern and Central Gas Corporation
Limited,

A. As recommended by The Ontario Energy Board, subject to the following terms and conditions that the acquisition be,

- (a) carried out in accordance with the scheme of arrangement, dated December 11, 1974, pursuant to section 193 of The Business Corporation Act, for the purpose of carrying out the amalgamation agreement of the same date between Newco Ltd. and Canadian Industrial Gas & Oil Ltd. ("Cigol"), without any modification or alteration of either unless it shall have been consented to by the Lieutenant Governor in Council; and
- (b) made no later than December 31, 1975, or, if the amalgamation is not then completed, by such later date as shall have been consented to by the Lieutenant Governor in Council;

B. And upon Newco Ltd. providing to the Lieutenant Governor in Council the undertakings set out below with an assurance satisfactory to the Lieutenant Governor in Council that such undertaking shall be performed by Newco Ltd., or Norcen Energy Resources Limited ("Norcen"), namely,

- (c) so long as Norcen and its successors have a sufficient number of the outstanding voting shares of Northern and Central Gas Corporation Limited to enable the former to exercise corporate control over

Northern and Central Gas Corporation Limited, and so long as the latter Company, itself or through an affiliate or subsidiary, shall carry on the business of distributing natural gas in Ontario, Norcen will,

(i) review annually with the Minister of Energy, with such detail as he may reasonably require, the present and future gas supply position of Northern and Central Gas Corporation Limited;

by the Lieutenant Governor in Council; and

(b) made no later than December 31, 1975, or, if the amalgamation is not then completed, by such later date as shall have been consented to by the Lieutenant Governor in Council;

B. And upon Newco Ltd. providing to the Lieutenant Governor in Council the undertakings set out below with an assurance satisfactory to the Lieutenant Governor in Council that such undertaking shall be performed by Newco Ltd., or Norcen Energy Resources Limited ("Norcen"), namely,

(c) so long as Norcen and its successors have a sufficient number of the outstanding voting shares of Northern and Central Gas Corporation Limited to en-

able the former to exercise corporate control over Northern and Central Gas Corporation Limited, and so long as the latter Company, itself or through an affiliate or subsidiary, shall carry on the business of distributing natural gas in Ontario, Norcen will,

- (i) review annually with the Minister of Energy, with such detail as he may reasonably require, the present and future gas supply position of Northern and Central Gas Corporation Limited;
- (ii) provide timely prior notification to the Lieutenant Governor in Council of any development or occurrence (of which Norcen has knowledge or information) following which control of Norcen (and indirectly therefore control of Northern and Central Gas Corporation Limited) could be acquired by any person or corporation distributing natural gas in Ontario;
- (iii) Newco Ltd. will cause Norcen, upon its incorporation, to apply for and use its best efforts to obtain, and if granted to keep current, an exemption from the

requirement to obtain approval to issue equity capital under the Alberta Gas Utilities Act similar to that now held by Cigol;

- (iv) cause such portion of the earnings of Northern and Central Gas Corporation Limited to be retained as is appropriate for retention by a gas distribution utility, and to the extent that such retained earnings are not sufficient to maintain the equity of Northern and Central Gas Corporation Limited at a level sufficient to enable Northern and Central Gas Corporation Limited to carry on its business of distributing gas in Ontario, Norcen will provide additional equity capital sufficient for that purpose, on terms at least as favourable as Northern and Central Gas Corporation Limited could have obtained itself directly from the market if the reorganization had not occurred: and, in the event an exemption is not obtained by Norcen from the Public Utilities Board of Alberta, in respect of the requirement, under the Alberta Gas Utilities Act, (mentioned in subclause (iii)

for prior approval to issue capital, and Norcen is unable to obtain approval under that Act to supply such additional equity to Northern and Central Gas Corporation Limited and is otherwise unable to supply such equity, Norcen agrees and undertakes to permit Northern and Central Gas Corporation Limited itself to raise equity from other sources including the issue of shares to the public, if required to carry on such business;

(v) Norcen will repay in each of the calendar years 1980 to 1999 inclusive an amount equal to 5% of the original principal amount of the demand promissory note to be issued by it to Northern and Central Gas Corporation Limited pursuant to the provisions of the said scheme of arrangement provided that all payments of principal of the said promissory note, whether made at the option of Norcen or as a result of a demand for payment by Northern and Central Gas Corporation Limited, will be applied in satisfaction of the payments due hereunder as they fall due.

The Committee of Council concur in the recommendation of the Honourable the Minister of Energy and advise that the same be acted on."

UNDERTAKINGS

BY NEWCO

In response to the Order-in-Council, Newco

undertook to carry out the following provisions

(Exhibit 18.3.3):

"As provided for in Order-in-Council No. 2116/75, Newco Ltd. hereby undertakes to the Lieutenant Governor in Council of Ontario on its own behalf and on behalf of Norcen Energy Resources Limited ("Norcen"), a company to be formed by the amalgamation of Newco Ltd. and Canadian Industrial Gas & Oil Ltd. ("Cigol"), that so long as Norcen and its successors have a sufficient number of the outstanding voting shares of Northern and Central Gas Corporation Limited to enable the former to exercise corporate control over Northern and Central Gas Corporation Limited, and so long as the latter company, itself or through an affiliate or subsidiary, shall carry on the business of distributing natural gas in Ontario, Norcen will,

(i) review annually with the Minister of Energy, with such detail as he may reasonably require, the present and future gas supply position of Northern and Central Gas Corporation Limited;

(ii) provide timely prior notification to the Lieutenant Governor in Council of any development or occurrence (of which Norcen has knowledge or information) following which control of Norcen (and indirectly therefore control of Northern and Central Gas Corporation Limited) could be acquired by any person or corporation distributing natural gas in Ontario;

- (iii) Newco Ltd. will cause Norcen, upon its incorporation, to apply for and use its best efforts to obtain, and if granted to keep current, an exemption from the requirement to obtain approval to issue equity capital under the Alberta Gas Utilities Act similar to that now held by Cigol;
- (iv) cause such portion of the earnings of Northern and Central Gas Corporation Limited to be retained as is appropriate for retention by a gas distribution utility, and to the extent that such retained earnings are not sufficient to maintain the equity of Northern and Central Gas Corporation Limited at a level sufficient to enable Northern and Central Gas Corporation Limited to carry on its business of distributing gas in Ontario, Norcen will provide additional equity capital sufficient for that purpose, on terms at least as favourable as Northern and Central Gas Corporation Limited could have obtained itself directly from the market if the reorganization had not occurred; and, in the event an exemption is not obtained by Norcen from the Public Utilities Board of Alberta, in respect of the requirement, under the Alberta Gas Utilities Act, (mentioned in subclause (iii) for prior approval to issue capital, and Norcen is unable to obtain approval under that Act to supply such additional equity to Northern and Central Gas Corporation Limited, and is otherwise unable to supply such equity, Norcen agrees and undertakes to permit Northern

and Central Gas Corporation Limited itself to raise equity from other sources including the issue of shares to the public, if required to carry on such business;

(v) Norcen will repay in each of the calendar years 1980 to 1999 inclusive an amount equal to 5% of the original principal amount of the demand promissory note to be issued by it to Northern and Central Gas Corporation Limited pursuant to the provisions of the scheme of arrangement dated December 11, 1974 by Northern and Central Gas Corporation Limited pursuant to section 193 of The Business Corporations Act, provided that all payments of principal of the said promissory note, whether made at the option of Norcen or as a result of a demand for payment by Northern and Central Gas Corporation Limited, will be applied in satisfaction of the payments due hereunder as they fall due.

IN WITNESS WHEREOF Newco Ltd. has executed this undertaking under its corporate seal at Toronto, Ontario on the 15th day of August, 1975."



NORTHERN AND CENTRAL GAS CORPORATION LIMITED • 4600 TORONTO-DOMINION CENTRE, TORONTO 1, CANADA

TELEPHONE 14181 868-4000

July 30, 1975

The Honorable Dennis Timbrell
Minister of Energy
Province of Ontario
12th Floor, 56 Wellesley Street West
Toronto, Ontario

Dear Mr. Minister:

As discussed yesterday with Robin Scott, it is our understanding that the undertakings contained in items (i) to (iv) inclusive of Section B of the draft of your recommendation to the Cabinet will not be included in the Leave to be granted by the Lieutenant Governor in Council pursuant to Section 26(2) of the Ontario Energy Board Act. The purpose of this letter is to reconfirm our position with respect to these points:

1. The executive offices of Norcen Energy Resources Limited will be located in Toronto, Ontario.

2. & 3. Norcen will apply for, and keep in force, an extra-provincial licence under Part IX of The Corporations Act of Ontario and will file annually the required return under The Corporations Information Act of Ontario.

4. The Board of Directors of Northern and Central Gas Corporation Limited will include two residents of the areas served by Northern and Central Gas Corporation Limited, neither of whom, prior to election

- had any pecuniary interest in Norcen Energy Resources Limited or any of its subsidiaries or affiliates or in Northern and Central Gas Corporation Limited and its subsidiaries and affiliates,
- was connected with the business of exploring for developing, producing, transmitting or distributing natural gas.

Yours very truly,

E. G. Battle
President and Chief Operating Officer

EGB:vm

APPENDIX D

GLOSSARY OF TERMS

ACQUISITION PREMIUM	the amount by which the purchase price exceeds the book value of the asset being purchased.
AGREEMENT	the purchase agreement made the 30th day of October, 1984, among Inter-City Gas Corporation, ICG Resources Ltd. and Vigas Propane Ltd. as Purchasers and Norcen Energy Resources Limited as Vendor for the purchase and sale of the common shares of Northern and Central Gas Corporation Limited.
ASSET COVERAGE	a measure of long term liquidity based on the number of times net tangible assets can cover outstanding short and long term debt.
BOOK VALUE	the amount shown in the books (journals and ledgers) or in the accounts for any asset, liability or owner's equity item.
BOND	a certificate to show evidence of debt.
BRIDGE LOAN	a loan made for a short period of time which is to be paid off at a given time by another form of financing.
CAPITAL STRUCTURE	the classification showing the proportion of the funds provided by lenders and owners to the business. e.g. long term debt, preferred stock, common equity.
CASH FLOW	cash received minus cash disbursed from a specific asset, or group of assets, for a given period.
COMMON SHARES	shares representing the class of owners who have residual claims on the assets and earnings of a company after all debt and preferred shareholders' claims have been met.
CONVERTIBLE PREFERRED SHARES	preferred shares which may be converted, at the holder's option, into a specified number of common shares.

COST OF CAPITAL	the rate a company must pay for the funds provided by lenders and owners.
DEMAND NOTE	an unconditional written promise by the maker (borrower) to pay a certain amount on demand.
FAIR MARKET VALUE	the value, determined at arm's-length, between a willing buyer and a willing seller, each of whom is acting rationally in his or her own self-interest - may be estimated in the absence of a monetary transaction.
FINANCIAL LEVERAGE	financing with debt and preferred shares to increase the potential return to the residual common shareholders' equity - however, the greater the proportion of debt and preferred shares in the capital structure, the greater the risk borne by the common shareholders.
FINANCIAL RISK	the uncertainty about corporate profit levels and the probability of financial distress and bankruptcy that accompanies the use of debt and preferred share financing in a firm's capital structure - the risk is usually more pronounced if the non-common-share financing is either short-term or subject to variable interest rates or variable preferred dividend rates.
FIRST MORTGAGE BONDS (OF NORTHERN)	senior debt obligations of Northern which, prior to the proposed acquisition, are owed to various life insurance companies - the current obligation is for approximately \$19,000,000 Canadian at 11 3/8 percent interest (\$4,080,000 in Canadian dollars, \$12,920,000 in U.S. dollars).
GOODWILL	the excess of cost of an acquired firm or operating unit over the current or fair market value of net assets of the acquired firm or unit.
HYPOTHECATE	to pledge without delivery of title or possession.
INTER-CITY NOTE	the proposed \$47,300,000 (7.6 percent interest) obligation of Inter-City to Northern - ideologically, for tax reasons, has a demand feature but realistically is not a demand note because of a legal undertaking, set out in the

Agreement, that Northern won't demand payment except according to the repayment schedule.

**INTEREST
COVERAGE**

a measure of long-term solvency, specifically the number of times that interest charges are earned or covered in a given period.

**NET TANGIBLE
ASSETS**

those assets, having a physical form, which are available to all bondholders.

NORCEN NOTE

prior to the proposed acquisition, a \$47,300,000 (7.6 percent interest) obligation of Norcen to Northern - a demand note.

PAYOUT RATIO

common share dividends declared for a year divided by net income to common shares for the year.

**PREFERRED
SHARES**

capital stock with a claim to income or assets after bondholders but before common shares.

PRESENT VALUE

value today of an amount or amounts to be paid or received later, discounted at some interest or discount rate.

**RETAINED
EARNINGS**

net income over the life of a company less all income distributions (including stock dividends) - can also be defined as owners' equity less contributed capital.

TRANCHE

a banking term used to describe one part (amount) of a total loan - the total sum of the loan is separated into parts or tranches because each tranche will differ either in repayment terms, interest rate, security pledged or draw down date.

WINNEX SHARES

the 500,000 common shares of Winnex.

